In Pursuit of Compliance:

Lessons from the World Trade Organization’s Dispute Settlement Mechanism

Carlos Frederico de Souza Coelho

cafrecoelho@hotmail.com

Supervisor: Dr. Antonio Ortiz Mena L.N.
ACKNOWLEDGEMENTS

The thesis here presented could not been concluded without a large support-system. What started in February of 2004 in the form of an application to Linkoping University ends almost two and a half years later, after two unplanned trips to Brazil, a successful research period in Geneva, dozens of emails, hours of Msn, days of a blank computer screen.

The Swedish Foundation for Higher Cooperation in Research – STINT, provided for the much necessary financial support. Without it, this could not have been started, much less concluded. I appreciate dearly the trust and generosity of the Foundation.

A Brazilian student with a Mexican supervisor at a Swedish University. My supervisor, Dr. Antonio Ortiz Mena L.N., prevented distance from being a problem and fueled what was at times a very slow vehicle. His comments and his incentive motivated this research. His encouragement in difficult circumstances will and cannot be forgotten.

Dr. Geoffrey Gooch, our Programme Director, has always been kind to find the time to accommodate an annoying student. His willingness to assist made this work so much easier.

The success of the research period in Geneva is a direct result of Dr. Antonio Ortiz Mena's insistence and of his networking in order to secure much needed interviews. In Geneva, Rambod Behboodi has become a friend. Iddo Dror, Knirie Sogaard and Ricardo Melendez-Ortiz were of remarkable generosity in helping me contact the people interviewed for this research. The interviewees welcomed a student with a notebook and a recorder with kindness. Their action is deeply appreciated.

My colleagues have supported me through thick and thin and I have benefited mightily from their presence. Efe Peker, Sandy Hager and Julian Germann have introduced me to a less traveled ideological road. Vivien Luttenschlager and Aurelie Marteau welcomed me into their homes. Jenny Ostberg kept me alive in the dangerous ski slopes of Northern Sweden. Marek Canecky and Jana Hadvabova have showed me Slovakian friendship and prevented me from starving. Weijing Cui has been constantly present. Ivan Timbs was the brother next door.

The support of my Brazilian friends made homesick hearsay.

Taciela was of instrumental support in guiding me through the tough days and the long nights. It is her fault this Master's thesis is being presented.

My family was, is and has been everything to me. Their love is undeserved and their support overwhelming. I could always count on them. Even from a distance, they have always been ever-present. Always will be.
This work is dedicated to the Coelhos. Taciela included.
CHAPTER 1
INTRODUCTION AND RESEARCH PARAMETERS ..................................................................................................... 10

1.1 AIM AND RESEARCH QUESTIONS ................................................................. 11
1.2. STRUCTURE OF THE THESIS .............................................................................. 12
1.3. THE DISPUTE SETTLEMENT MECHANISM IN THE WTO: AN INTRODUCTION ...................................................... 14
1.4. REVIEW OF RELEVANT LITERATURE......................................................................................................................... 16
1.4.1. THEORETICAL LITERATURE ............................................................................. 16
1.4.2. EMPIRICAL LITERATURE ................................................................................ 19
1.5. METHODOLOGY ........................................................................................................... 19
1.5.1. COMBINING QUANTITATIVE AND QUALITATIVE APPROACHES ......................... 22
1.5.2. USING CASE STUDIES ...................................................................................... 23
1.5.3. DATA COLLECTION ........................................................................................... 26
1.6. DEFINITIONS OF CONCEPTS ................................................................................ 27
1.7. DELIMITATIONS .................................................................................................... 28

CHAPTER 2
THEORETICAL FRAMEWORK ................................................................................................................................. 29

2.1. UNDERSTANDING COOPERATION IN TRADE ................................................. 30
2.2. THE PUSH TOWARDS LEGALIZATION IN THE INTERNATIONAL ARENA ................. 31
2.2.1. BRIEF OVERVIEW .......................................................................................... 31
2.2.2. LEGALISM AND THE WTO: A RULES-BASED MECHANISM ............................. 32
2.3. COMPLIANCE THEORY ....................................................................................... 34
2.3.1. MANAGING COMPLIANCE .............................................................................. 34
2.3.2. THE ENFORCEMENT SCHOOL .......................................................................... 36
2.3.3. ENHANCING COMPLIANCE THROUGH A COMPLEMENTARY APPROACH ......... 37
2.4. ANALYTICAL FRAMEWORK: EXPECTATIONS AND TESTS ..................................... 38

CHAPTER 3
COMPLIANCE AND DISPUTE SETTLEMENT UNDER THE WTO: IS THERE A PROBLEM? ..................................... 40

3.1. WHAT DO THE STATISTICS SHOW? IS THERE MORE TO IT? ......................................... 42
3.2. NONCOMPLIANCE: WHEN THE SYSTEM FAILS .................................................... 44
In pursuit of compliance: Lessons from the WTO’s Dispute Settlement Mechanism

3.2.1. THE AIRCRAFT DISPUTES BETWEEN BRAZIL AND CANADA ..................................................... 44
3.2.2. THE BANANAS CASE .............................................................................................................. 50
3.2.3. CONGRUENCIES IN NONCOMPLIANCE CASES ....................................................................... 54
3.3. IS THERE A PROBLEM WITH COMPLIANCE? ............................................................................. 57

CHAPTER 4
RETALIATION (OR LACK THEREOF) UNDER THE WTO ................................................................. 60
4.1. THE LOGIC OF RETALIATION .................................................................................................... 61
4.1.1. STATISTICAL ANALYSIS ON RETALIATION ........................................................................... 62
4.2. COMPLIANCE AND ECONOMIC ASYMMETRIES ..................................................................... 64
4.2.1. WHY RETALIATE? WHY NOT? ............................................................................................... 65
4.2.1.1. THE ECONOMIC EXPLANATION .................................................................................. 65
4.2.1.2. THE POLITICS OF RETALIATION .................................................................................... 67
4.3. THE EFFECTS OF THE CURRENT RETALIATION PROCESS ON COMPLIANCE THEORY ....... 70
4.3.1. NO PUNISHMENT, NO PROBLEM? ....................................................................................... 70

CHAPTER 5
HOW TO ENHANCE THE DISPUTE SETTLEMENT MECHANISM: PROPOSALS FOR REFORM ............ 72
5.1. A NEED FOR REFORM ........................................................................................................... 73
5.2. ASSESSING CURRENT REFORM PROPOSALS ........................................................................ 74
5.2.1. A FAR REACHING REFORM: THE PROPOSAL BY MEXICO .................................................. 75
5.2.2. THE CALL FOR MODERATION: DO NO HARM .................................................................. 77
5.3 PURSUING COMPLIANCE THROUGH MANAGEMENT OR ENFORCEMENT? ....................... 78

CHAPTER 6
CONCLUSIONS .................................................................................................................................. 81
6.1. RESEARCH FINDINGS ............................................................................................................. 82
6.2. RECOMMENDATIONS FOR FURTHER RESEARCH ................................................................. 83
REFERENCES.................................................................................................................................... 85
<table>
<thead>
<tr>
<th>INTERVIEW ROSTER</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Celso Lafer</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Rambod Behboodi</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Fernando Pierola</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Dr. Serge Pannatier</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Lotty Andrade Abdo</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Esperanza Durán</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Dr. Arthur E. Appleton</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Knirie Sogaard</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Ricardo Melendez-Ortiz</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Scott D. Andersen</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Jorge A. Huerta Goldman</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Mateo Diego-Fernandez</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Nilo Dytz</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Dr. Renato Flores</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Dr. Ken Shadlen</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

Other interviewed people who have asked not to be named include a high-ranking official from the WTO, a high-ranking official from the European Communities and a high-ranking official from Brazil. The research will honor the agreement made with those officials and refer to them as above described.
ABSTRACT

The purpose of this thesis is to examine if there is a problem with compliance in the World Trade Organization, to investigate the validity of the managerial and the political economy approaches to compliance and to analyze reform proposals that tackle the issue of compliance, pursuing improvement of the system.

Drawing on the scenario of increasing legalization and cooperation in trade, the first question is examined by way of interviewing trade experts and officials as well as analyzing case studies that are pertinent to the research at hand. The second question – if management is preferred to enforcement as to induce compliance – is answered by analyzing official WTO Dispute Settlement reports, interviews, case reviews and articles on retaliation and compliance written by different authors. The third question is answered as a reflection of the findings of the first two questions.

Analysis on the managerial theory of compliance examine whether enforcement plays a minor role in inducing compliance in the WTO, if there is a propensity to comply amongst states and if noncompliance is inadvertent rather than a result of calculation of interests. In the other hand, tests conducted on the enforcement approach to compliance investigate the importance of retaliation in WTO Dispute Settlement, the necessity of an enforcement tool and the claim that noncompliance is a political decision.

Tests conducted suggest that the enforcement school of compliance is correct when stating that noncompliance is a political decision, resulted from careful calculation of interests. The research indicates that the WTO Dispute Settlement presents a dual facet of compliance, in which the enforcement tool is responsible for allowing the managerial effects to take place. In this regard, the enforcement tool alone is seen as inappropriate, especially if economic asymmetries are present. An approach that accommodates both enforcement and managerial aspects is prescribed.

The research has indicated that successful reform proposals should aim at increasing the credibility of the threat of retaliation as to follow the diagnosis verified by the tests conducted.
List of Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>DS</td>
<td>Dispute Settlement</td>
</tr>
<tr>
<td>DSB</td>
<td>Dispute Settlement Body</td>
</tr>
<tr>
<td>DSM</td>
<td>Dispute Settlement Mechanism</td>
</tr>
<tr>
<td>DSU</td>
<td>Dispute Settlement Understanding</td>
</tr>
<tr>
<td>EC</td>
<td>European Communities</td>
</tr>
<tr>
<td>ECJ</td>
<td>European Court of Justice</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
</tr>
<tr>
<td>ICJ</td>
<td>International Court of Justice</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>MFN</td>
<td>Most Favoured Nation</td>
</tr>
<tr>
<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
</tr>
<tr>
<td>PROEX</td>
<td>Export Financing Program</td>
</tr>
<tr>
<td>US</td>
<td>United States of America</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
</tr>
</tbody>
</table>
List of Charts and Figures

Figure 1: Evolution of the number of complaints brought before the WTO’s DSM ................................................................................................................................. 19

Figure 2: Evolution of the number of compliance panels opened in the WTO’s DSM .......................................................................................................................... 20

Figure 3: Table on the number of cases where retaliation was allowed................................................................. 42

Figure 4: Table on the percentage of cases where retaliation was allowed............................................................. 42

Figure 5: Number of complaints brought before the WTO’s Dispute Settlement Mechanism (by country) ................................................................. 44

Figure 6: Compliance Pendulum............................................................................................................................... 56

Figure 7: Chart on the use of retaliation..................................................................................................................... 63
CHAPTER 1

INTRODUCTION AND RESEARCH PARAMETERS
1.1 AIM AND RESEARCH QUESTIONS

To comply or not to comply? That is the question.

The Vienna Convention on the Law of Treaties has long established every international agreement as legally binding\(^1\); however, the issue of compliance with international laws and treaties is at the heart of any discussion in international law. Clouded by questions such as state sovereignty and the inexistence of a coercive supranational authority, this issue remains one of the never-ending academic discussions of our time. As cooperation in international relations has increased, so has the necessity to find viable solutions to the aforementioned problem. In light of that, the question of compliance with international agreements is essential to the study of international relations. What makes states comply? Why do they comply? Why not? What makes them desert the system they have created? These questions are implicit in any discussion about compliance in the international arena. It is the purpose of this thesis to investigate them in an explicit way.

In order to generate the answers to the questions asked above, it is necessary to focus on a particular event or institution, as the world today sees such different “regulating” institutions such as the International Criminal Court, the International Court of Justice, ad-hoc tribunals and many others. In the present work, the analysis here offered will be focused exclusively on the World Trade Organization (WTO), and more specifically, in its Dispute Settlement mechanism (DSM) In the words of Jackson (1998, p.176), the creation of the Dispute Settlement Body in the WTO “is likely to be seen in the future as one of the most important, and perhaps even watershed developments of international economic relations in the twentieth century”. Of the same opinion is Shaffer (2003, p. 2), for whom the Dispute

\(^1\) Article 26 of the Vienna Convention on the Law of Treaties establishes the principle of *pacta sunt servanda* by stipulating that “*Every treaty in force is binding upon the parties to it and must be performed by them in good faith.*”
Settlement procedure at the WTO marks “a new development in international economic relations in which law, more than power, might reign”.

As such, the Dispute Settlement mechanism at the WTO sets itself apart as an important unit of analysis, capable of providing answers that are relevant to compliance. How to achieve compliance in international trade in a dispute settlement mechanism that is characterized by procedures that are typical to domestic courts? The present study will investigate the peculiarities and lessons that can be inferred from such scenario.

The research questions that will guide the present work are three-fold:

1. Is there a problem with compliance in the WTO?
2. Is enforcement preferred to management, in order to achieve compliance?
3. What changes can be proposed and implemented to enhance compliance with the WTO’s Dispute Settlement mechanism decisions?

The first research question aims to examine the current state of compliance in the World Trade Organization’s Dispute Settlement mechanism, followed by an analysis on ways to achieve higher rates of obedience and finally by translating those theoretical lessons into practical modifications that, once carried out, could result in enhancement of the current system.

1.2 STRUCTURE OF THE THESIS

The present work is divided in six different chapters. In Chapter 1, a brief introduction to the thematic is offered. This is done in conjunction with the posing of the research questions that guide the present study. Also, in Chapter 1 the confines and parameters in which this study is to be conducted are established, along with a review of previous literature – theoretical and empirical – that is set out in order to provide for better understanding of the current status of research in the field. The methodology is described as to
allow the reader to understand how answers will be sought and fundamental concepts and
terms pertinent to the issue at hand are established.

In Chapter 2, the theoretical framework in which this research will be
conducted is set out. Therefore, in this chapter the elements concerning cooperation in trade
are introduced and the atmosphere in which the Dispute Settlement Mechanism in the WTO
originated – increasing legalism – is object of scrutiny. Subsequently, the elements pertaining
to each strain of compliance is analyzed. Firstly, the view favoring management of
compliance is detailed, followed by the same level of analysis on the enforcement theory.
Finally, an intersection of the ideas of legalism and compliance is done with the unit of study
– the WTO - as to properly set up the ideas surrounding this thesis.

In Chapter 3, one of the research questions is studied, as the thesis analyze the
current state of compliance with WTO DS decisions. Statistical analysis of the issue is
provided as well as an analytical review of what do the numbers mean. This chapter describes
cases where there have been noncompliance, in way of examining the disputes between
Canada and Brazil regarding aircrafts and the benchmark case involving bananas. Other cases
are cited so as to pinpoint congruencies in noncompliance occurrences. In this chapter,
theories of compliance begin to be investigated and examined.

Chapter 4 examines the topic of retaliation, the Dispute Settlement
mechanism’s last resort and the dynamics that are intrinsic to the use of such measure in other
to achieve compliance. In order to achieve a satisfactory answer to the aforesaid question, the
thesis provides analysis on the use of retaliation – WTO’s ultimate means of enforcement - by
different countries and investigates the reasons behind countries’ decisions to retaliate (or
not). The chapter concludes by weighing in on the effects that the current retaliation process
has on compliance and on the theoretical approaches here presented.
What measures could be taken in order to induce higher compliance rates are the focus of Chapter 5. The chapter begins by investigating the need – or lack thereof – for reform in the WTO’s DSM, followed by a critical assessment of proposals current under consideration. Mexico’s aggressive proposal is given special attention as are other compliance items present in other propositions. The chapter finishes by analyzing from which strain of compliance the proposals derive from and suggests items for reform that appear likely to find broad consensus.

Finally, in Chapter 6, a conclusion to the presented research questions is offered, presenting final considerations on the investigated topic and introducing possible research ideas that could be further explored.

1.3 THE DISPUTE SETTLEMENT MECHANISM IN THE WTO: AN INTRODUCTION

Whereas the importance of the WTO’s DSM was shown above, it is necessary to explain briefly how it does works, drawing attention to some general guidelines as well as some specific regulations, especially those concerned with compliance.

According to the WTO’s official view, “Dispute settlement is the central pillar of the multilateral trading system, and the WTO’s unique contribution to the stability of the global economy.”2 Such was the case in 1995, when as a result of the Uruguay round of negotiations the WTO was created, with some seeing the dispute settlement procedures as the “crown jewel” of the organization (Bacchus 2002, p.8; Hauser & Zimmerman 2003, p.241). The “crown jewel” as it is called, is regulated by the Understanding on Rules and Procedures Governing the Settlement of Disputes, or as it is more commonly referred to, Dispute Settlement Understanding – DSU. The DSU serves as the legal basis for every decision made.

http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm All websites presented in this thesis were checked and were functional as of May 2, 2006.
under the umbrella of the WTO’s Dispute Settlement mechanism. It bears necessity then, to briefly examine some of the peculiarities of this collection of rules, in order to understand the functioning of settling disputes in the World Trade Organization.

The first and probably most striking characteristic of the change proposed by these dispute settlement procedures is that its decisions are binding, in stark opposition to the dispute settlement procedures established under the General Agreement on Tariffs and Trade – GATT, which allowed for the blocking of decisions made in its Dispute Settlement mechanism (Jackson 2000, p.184). This is a central change to the approaches taken by countries towards a more legalistic system in respect to international trade. It so is then, that once a decision is made by the WTO DS Body, it becomes a matter of international law (Jackson 2000, p. 185).

It must be noted that the main purpose of Dispute Settlement in the WTO is to bring every country in compliance with the thousands of pages that are peculiar to trade agreements. In this sense, should a country be found to be in violation of a covered agreement, it can escape any penalties by conforming to the decision of the panel or the Appellate Body at the WTO. That is expressed very clearly under Article 19.1 of the Dispute Settlement Understanding, which states that:

“Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement.”

Another key characteristic of the present in the DSU and also central to the research is the compliance review established by Article 21.5, which states:

“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.”

It is under such recourse that compliance with WTO agreements will be determined. Should a country be found, under the compliance review prescribed by article 21.5, to be still in violation of covered agreements, it will be subject to the penalties set out on Article 22.2, which calls for suspension of concessions, as seen below:

“(…)If no satisfactory compensation has been agreed (…), any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.”

1.4. REVIEW OF RELEVANT LITERATURE

A review of relevant literature in a research study accomplishes several purposes (Creswell 2002, p. 29), in order to allow the reader to understand the importance of previous major studies as well as setting important benchmarks for the study to follow. It is in that perspective that the literature review should be seen below.

1.4.1. Theoretical Literature

In order to tackle the issue of compliance with WTO decisions and whether more enforcement is preferred to more management, the present thesis will take as theoretical

---

3 There is a discussion about sequencing procedures in the WTO, which is to say that countries sometimes do not agree on when suspension of concessions can be applied. The present research will bypass this discussion as nowadays it is commonplace for countries to agree to a sequencing procedure before the dispute.
underpinning what is commonly referred to as “compliance theory”. As such, an analysis will be provided as to set forth what do the two major strains of compliance theory – managerial and enforcement - establish as their main characteristics. It will also be noted that there is an attempt to provide a complementary, synthetic approach to the issue.

An historical overview about the compliance thematic is advanced by Raustiala and Slaughter in *International Law, International Relations and Compliance* (2002). In the article, the authors defend the idea that compliance literature is a microcosm of developments in the fields of international law and international relations, introducing the suggestion that future compliance studies would have to rely on interdisciplinary work (2002, p. 538). The authors chronologically organize the views of international law and international relations scholars, noting: “(…) the progression of each discipline separately; the conjunction of the two disciplines as captured by cross-cutting analytical categories, the ways in which each discipline responds to each other” (2002, p.539).

Professor Louis Henkin, from which the managerial perspective seem to have drawn inspiration, in his 1968 classical book “How Nations behave”, suggested that “(…) almost all nations observe almost all principles of international law and almost all of their obligations almost all of the time” (p.47). Arguably the most famous sentence in compliance literature, it serves as evidence to what Henkin defines as hardly noted: the silent respect of nations to thousands of international commitments everyday (1968, p.47). Although thorough in setting forth the existence of compliance, Henkin was less eloquent in explaining why nations comply, a thought echoed by Raustiala and Slaughter (2002, p.540).

With the goal of explaining the rise of legalization in international relations, various articles and authors will serve as theoretical underpinning. They include mostly those included in a special issue of *International Organization* (2000 Vol.54, No. 3) that analyzed the effects of a move towards law (Goldstein *et al.* 2000, p.385). Also of great importance
will be the work of scholars specialized in international economic law, who have over the years analyzed the effects of increasing legalization, this time providing a linkage to the issue of dispute settlement and the WTO, to which articles by Professors Ernst-Ulrich Petersmann and John H. Jackson are an example.

The literature on legalization will address such things as the inadequacies of the hobbesian view on international law (Petersmann 1998, p. 175), a “paradigm shift” of how to think about international law fundamentals (Jackson 2005, p. 3) and the challenges facing a process – legalization – that is not uniform or without conflicts (Goldstein et al, 2000). Along with views on legalization, perspectives on cooperation (Keohane 1984) and trade will properly set up the legalist-cooperative scenario in which the WTO Dispute Settlement Mechanism functions.

Finally, when studying the issue of compliance *per se*, literature on both the managerial and the enforcement thesis will be addressed. Chayes & Chayes advocate a managerial thesis of compliance in their benchmark article “*On compliance*” (1993) and later in *The New Sovereignty: Compliance with International Regulatory Agreements* (1995), suggesting that optimum compliance results are achieved when enforcement of commitments is sought through assistance and persuasion rather than through coercive sanctions (Chayes & Chayes 1993, p. 205). Downs, Rocke & Barsoom argue just the opposite, prescribing tougher punishment to sustain deep regime commitments, as the benefits of defection increase with deeper cooperation (1996).

Additional literature may be cited through the course of the thesis, with Jonas Tallberg’s (2002) attempt to bridge the managerial-enforcement divide and Thomas Schelling’s classic work (1960) on threats and the elements of bargaining – which earned him a recent Nobel award - as two examples.
1.4.2. Empirical Literature

The Dispute Settlement Body of the World Trade Organization, albeit fairly young – 10 years – has been the focus of extensive scrutiny by international trade experts, lawyers and social scientists. Much of the scholarly material about the WTO, however, even in the present day, focuses on the novelty and the peculiarities of an international legal structure that makes binding decisions. Another area of intense study is that of the participation of countries in the system as well as analysis on separate cases.

Thus, the study of compliance with WTO DS decisions is one that runs in parallel with the aforesaid ones. Nevertheless, there is a variety of studies on retaliation, which is one of the facets of present work as well as a small number of articles that approach the issue of compliance *per se*, one of which is the yearly statistical analysis provided by Leitner & Lester (2006). In the first table presented by the authors, it is possible to note the evolution of complaints within the DS system of the WTO as below (Leitner & Lester 2006, p. 220):

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Complaints</td>
<td>25</td>
<td>39</td>
<td>50</td>
<td>41</td>
<td>30</td>
<td>34</td>
<td>23</td>
<td>37</td>
<td>26</td>
<td>19</td>
<td>11</td>
</tr>
</tbody>
</table>

*Fig. 1: Evolution of the number of complaints brought before the WTO’s DSM*

---

4 Leitner & Lester kindly provided such figures before they appeared at an article on the Journal of International Economic Law.
To the interest of the thesis at hand is the relation found between the number of complaints brought into the DS mechanism and the number of Article 21.5 panels which found respondents to be in noncompliance, which, as previously explained, are formed when there is disagreement over compliance with decisions and rulings of the Dispute Settlement Body. The figures involving Article 21.5 panels until 2005 are as in Fig. 2 below (Leitner & Lester 2006, p.228):

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Complaints</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>5</td>
<td>4</td>
<td>5</td>
<td>1</td>
<td>0</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

*Fig. 2: Evolution of the number of compliance panels opened in the WTO’s DSM*

These numbers and what they mean will be object of greater scrutiny at a later stage of this work, where, by analyzing interviews with trade experts and officials and cases where there has been non-compliance, it will be possible to draw a conclusion on whether there is a problem with compliance in the WTO, thus answering one of the research questions of this thesis. The second question – if management is preferred to enforcement as to induce compliance – of this thesis will be answered by analyzing official WTO Dispute Settlement reports, interviews, case reviews and articles on retaliation and compliance written by different authors. The third question to this thesis – how to improve the Dispute Settlement mechanism – will be in direct connection to the findings of the second investigation.
Official reports of the WTO will provide necessary background information to set up the present status of disputes in the settlement mechanism, therefore acting as a starting point to analytical inferences. Through interviews, it will be possible to note the opinion of different expert practitioners in this field, many of whom advocate that the idea of harsher sanctions could backfire, resulting in an inflexible system that might fall apart because of intense political pressure (Behboodi5; Dytz6; Appleton7). Others believe that the WTO should move in pursuit of an even more legalistic system (Duran8; Pierola9), in what Flores10 described as a move to “criminalize the system”, thus not acting as a forum for the settlement of disputes but, rather, as a trial court.

The issue of compliance with WTO Dispute Settlement decisions has been the focus of increasing attention by international trade experts. As such, there are a number of articles in which such theme is specifically addressed. Most articles, however, albeit excellent sources of information, appear to fall short of offering a comprehensive analysis of the compliance issues facing the WTO. Even more rare – possibly inexistent – is explicit reference to management and enforcement in theories of compliance, a reflection of a divide that appears to still persist between scholarship and practice.

In any case, McGivern’s views exposed on his article “Seeking compliance” (2002) are perhaps the most thorough analysis of the issue of compliance. In this article, McGivern explains the logic behind retaliation as well as its pros and cons, identifies cases and examples where there have been problems and propose different ways of achieving compliance, examining different methods such as political pressure, compensation or fines.

5 Interview given in Geneva on October 17, 2005.
6 Interview given in Geneva on October 14, 2005.
7 Interview given in Geneva on October 22, 2005.
8 Interview given in Geneva on October 8, 2005.
9 Interview given in Geneva on October 23, 2005.
10 Interview given in Rio de Janeiro on June 19, 2005. Professor Flores’ analogy relates to the nature of most criminal systems of law, where there is no room for negotiation after the imposition of a sentence.
carousel retaliation\textsuperscript{11}, collective retaliation\textsuperscript{12} and punitive retaliation\textsuperscript{13}. The author concludes by stating that the optimism of some that retaliation would serve as a powerful tool of compliance was mistaken and that the binding nature of dispute settlement decisions under the umbrella of the WTO is no assurance of compliance as the systems has its limitations (2002, p. 157). Unfortunately, the author does not offer an opinion of which course of action should be taken.

As to the possible modifications on the DSM, several countries have proposed different modifications. Most of the modifications proposed are to ensure a singular interpretation of controversial DSU writings. They address the issue of compliance in a peripheral manner, as oppose to a proposal advanced by Mexico, which is aimed squarely at the compliance issue. Supported by a study presented by Bagwell, Mavroidis & Staiger (2004), Mexico proposes a system that can be roughly described as an “auction of retaliation rights” or as defined by the aforesaid Professors, “\textit{tradable remedies}”. Such solution would help solve, in the opinion of Mateo Diego-Fernandez and Jorge Huerta Goldman\textsuperscript{14}, one of the problems associated with compliance, namely the impossibility or difficulty that countries have in carrying out a punishment that is trade distorting (retaliation).

1.5. \textbf{METHODOLOGY}

1.5.1. Combining quantitative and qualitative approaches

It will not be uncommon for qualitative and quantitative methods to be viewed together in the present study. An investigation on the number of compliance panels opened in relation to the number of complaints, for example, will be combined with case-study research.

\textsuperscript{11} Carousel retaliation logic prescribes the rotation of products subject to sanctions.

\textsuperscript{12} Collective retaliation would allow all countries to retaliate the losing party.

\textsuperscript{13} Punitive retaliation prescribes punishing the losing party in more than just the level of nullification or impairment sustained by the complaining party.

\textsuperscript{14} Interview given in Geneva on October 20, 2005.
The combined use of a qualitative and quantitative approach, what Bryman calls multi-strategy research (2001, p. 443), also works as a way to minimize the criticism aimed at each separate method. However, there are arguments made against such a strategy, and Bryman points out two of them (2001, p. 444-445). Firstly, is the notion that methods carry epistemological commitments, which is to say that they make it impossible to conciliate and integrate quantitative and qualitative research. Secondly, is the idea that qualitative and quantitative researches are paradigms, and as such they are also incompatible with each other.

When a qualitative approach is adopted as a research strategy, it usually leads to creation rather than testing of theories (Bryman 2001, p. 21), something more easily associated with a quantitative perspective. The distinction between perspectives can be best summed up by the idea that “(...) quantitative research employ measurement and qualitative researchers do not” (Bryman 2001, p. 20). In spite of the apparent notion that these two different research strategies cannot be combined, a more open-minded view of the subject allows for the combination of strategies, something Bryman concludes is not only feasible, but desirable (2001, p.445), a thought echoed by Punch (1998, p.243).

1.5.2. Using case studies

It appears that the best methodology available is to combine the case-study approach with analysis of available documents, including statistics, reports and submissions to the dispute settlement panel. Since the WTO, apart from the DSU, makes decisions on a case by case basis, where precedents are set for the future in the form of jurisprudence, it seems only natural for this thesis to follow the same path. As a result, by analyzing the cases at hand, considerations will be made that would be applicable to the system as a whole. According to Robert Yin, “case studies are the preferred strategy when “how” or “why” questions are
In pursuit of compliance: Lessons from the WTO’s Dispute Settlement Mechanism

... being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon with some real-life context” (2003, p.1).

The use of case studies as a research strategy is not without criticism. Considered by some social scientists as the weakest of methodologies (Van Evera 1997, p.51), case studies are criticized by those who argue that it does not provide a good foundation for scientific generalization (Yin 2003, p.10). One other constant criticism of case studies is placed on the investigators who conduct them (Yin 2003, p. 10-11) as they constitute a difficult enterprise to take and there are no clear-cut criteria as to define who is skilled enough to conduct a case study and who is not.

There a number of ways in which it is possible to minimize the criticism addressed at case studies as a research strategy. Van Evera argues that the logic behind the argument that case studies’ results cannot be generalized are applicable only to single-case designs (1997, p.53) whereas Yin defends, in a related logic, that the results of case studies are based on multiple experiments that replicated alike phenomenon under different conditions (2003, p.10). It becomes clear then, that the choice of a multiple-case design is preferable to a single-case one, as conclusions produced as a result of multiple studies will logically be of greater power (2003, p.53).

Of the several purposes that case studies can be used for, two of them will deserve special attention from this thesis: testing and creating theories (Van Evera 1997, p. 55). Van Evera sheds light on the steps that should be taken while testing a theory, namely: “(...) (1) state the theory; (2) state expectations about what we should observe in the case if the theory is valid, and what we should observe if it is false; and (3) explore the case (or cases) looking for congruence or incongruity between expectation and observation” (Van Evera 1997, p.56). This process is of fundamental importance to understanding the methodology that will permeate this thesis, as the present work, as will be later explained in
detail, will test managerial and enforcement theories of compliance in relation to the settlement of disputes in the WTO.

In order to create theory while using case studies as a research strategy, researchers should search for testimony from actors involved in the case as well as connections between different events, as to find a common trend (Van Evera 1993, p.68). By controlled comparison, using Stuart Mill’s method of difference or agreement, the investigator might either concentrate on cases with similarities as to explore different results on the object of study (compliance) or focus on cases where the characteristics are different but the results, the same (Van Evera 1997, p. 68-69). If neither the managerial or enforcement theses provide an explanation to the compliance questions pertaining this study, it will be necessary to make use of Van Evera’s and Mill’s prescriptions to satisfy the need for a theory of compliance regarding the WTO. Also, these guidelines will be of much importance when scrutinizing different reform proposals.

Finally, special consideration should be given to choosing which cases to study. Van Evera (1997, p. 77-88) details a list of eleven considerations that should be taken into account when making said decision. Although many of them are not relevant to the work at hand, given the chosen research strategy, it is useful to stress what are considered to be good cases to examine in this study. The first suggestion is to select cases that are rich in data, as they allow more questions to be asked (Van Evera 1997, p. 79). By selecting cases where there are competing theories (management and enforcement) making opposite predictions, it will be possible to test the theories’ explanatory power (Van Evera 1997, p. 83). In order to infer a new theory, the method of controlled comparison requires that either cases with similar characteristics and different results be chosen or vice-versa and finally, Van Evera argues that the investigator should select cases for test replication, as “(...) thorough theory testing requires repeating initial tests to corroborate their results.”
1.5.3. Data Collection

According to Yin, there are six different sources of information when it comes to case studies, namely: documents, archival records, interviews, direct observation, participant observation and physical artifacts (2003, p.83). Regardless of the source of data most preferred, it is of utmost importance to follow key principles of data collection. These principles prescribe using multiple sources of evidence, the creation of a database and the maintenance of a chain of evidence – which is to show the reader that “A → B” (2003, p.83).

For the purposes of this thesis, official documents produced by the World Trade Organization (reports, decisions) will be of support to the work at hand, providing essential primary source of information. Secondary sources of information such as analysis of compliance in the WTO and articles on compliance will also be part of documentary data to be processed by this study. In spite of the importance of such key documents, it should be stressed that they were not produced in light of the study at hand, hence, the burden is on the investigator to critically interpret the material available as to avoid the transformation of documentary information into unmitigated truths (Yin 2003, p.88-89).

In this particular study, interviews conducted during the research phase will be of particular importance, albeit necessary to stress that conducted interviews place the same burden related to how the investigator should analyze documents. Interviews conducted with high-ranking trade officials from different countries and expert practitioners of WTO DS are critical to the success of the thesis, an assertion first made by Yin when describing the role of key informants (2003, p.90). Pursuing the goal of multiple sources of information, prominent informants are able, in the words of Yin, to “(...) provide the case study investigator with insights into a matter but also can suggest sources of corroboratory or contrary evidence –
and also initiate the access to such sources” (Yin 2003, p. 90). The interview process conducted in this study fulfilled each of the aspects cited by the aforesaid author.

1.6. DEFINITIONS OF CONCEPTS

Expressions and concepts carry different meanings, depending on the subject and the person interpreting them. Consequently, it is necessary to state, clearly and explicitly the precise meaning of the terms and definitions that will be used in the present research.

When discussing compliance, such term should be interpreted in relation to the decisions made by the WTO’s Dispute Settlement procedure and not in relation to obedience to WTO’s covered agreements, which is what, originally, triggers the settlement mechanism. In that sense, to comply with the DS decisions is to bring, after a decision was made, the embattled norm in conformity to trade agreements under the umbrella of the WTO. Failure to do so results in noncompliance.

As it relates to the suspensions of concessions prescribed by the compliance panel as set out by article 21.5 of the DSU, the term that will be used in this thesis will be retaliation, as it is widely used by academicians, expert practitioners and even the general public.

In the present research, the term legalization should be seen as reflective of the emerging importance that courts hold in international relations, constraining governmental action through the use of legal instruments. As pointed out by Goldstein et al, “the delegation of authority to a neutral entity for implementation of the agreed rules, including their interpretation, dispute settlement and (possibly) further rule making” (2000, p. 387).

Finally, a term that needs addressing is “developing countries”. In this research, a developing country will be one that is listed as such, at the WTO. The Organization uses a system of self-declaration, dividing the countries in developed,
developing and least developed countries. As such, the term will include different countries such as Brazil and Ecuador, India and Costa Rica.

1.7. DELIMITATIONS

In order to limit the amount of information and the scope of analysis of the research, it is necessary to establish the confines in which this study will be conducted. Since the topic of compliance in the WTO is a contemporary issue and discussions are ongoing, this research will be limited, in regards to its temporal dimension, to the events and facts available from the creation of the World Trade Organization in 1995 to November 1, 2005.

Also, in regard to case-study analysis, it must be stressed that only those issues related to compliance are going to be analyzed. In any case brought before the WTO there are literally thousands of pages containing all sorts of information. It is not the purpose of this research to analyze whether a decision was good or bad, fair or unfair nor is the goal of the work at hand to provide thorough description of the cases here analyzed. Only those issues related to the implementation of WTO’s rulings and compliance thematic are of relevance to the present study.

Finally, it is important to note that the present thesis will demand a basic knowledge of the WTO’s DS mechanism, as it is not the purpose of the present work to explain step by step how the system operates, but rather, to provide analysis on how it addresses the problem of compliance and implementation of its decisions. As a result, general explanations of the DSM will be kept to a minimum, not by omission but by design, in order to avoid an irrelevant and superficial description of facts.
CHAPTER 2

THEORETICAL FRAMEWORK
2.1 UNDERSTANDING COOPERATION IN TRADE

Whereas the ability or inability of the World Trade Organization to achieve its goals is subject to judgment, depending on who is asked, one thing is clear: every country seem to want to be a part of it, as exemplified by the number of current members and the number of members currently holding accession talks. The WTO today has 148 members\textsuperscript{15}, with currently 31 countries participating on accession discussions\textsuperscript{16}. As such, cooperation in trade is high, and appears to be on the rise.

Keohane tackles the notion of cooperation as to say that “cooperation requires that the actions of separate individuals or organizations (...) be brought into conformity with one another through a process of negotiation, which is often referred to as policy coordination” (1984, p. 51). The World Trade Organization is, without a doubt, a forum used by different actors to ensure that trade policy is coordinated so that a common set of policies can be achieved.

Increasing interdependence on trade through the years has pushed countries to find agreements on trade. From a consumer perspective alone, it makes little sense to buy domestic goods that can be bought for a cheaper price from another country. As such, cooperation on trade has developed rather quickly, whether it was the European Union’s integration process, the North American Free Trade Agreement, Mercosur and other regional agreements. On a global perspective, the WTO agreement of 1995 has provided the backbone for international trade negotiations, establishing a common set of rules and policies that should be followed by all members.

It is in this light that the Dispute Settlement Mechanism should be viewed. It is part of a larger structure, designed to ensure that trade cooperation is attained. If cooperation

\textsuperscript{15} http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm
\textsuperscript{16} http://www.wto.org/english/thewto_e/acc_e/status_e.htm
is the product of a successfully coordinated policy, then, when it comes to trade, the Dispute Settlement mechanism is the product of a trade policy that has been successfully coordinated by members of the World Trade Organization. This is not to imply that conflicts will not exist – every case brought upon the DSB is, indeed, a trade conflict – but as Keohane points out, “cooperation should not be viewed as the absence of conflict, but rather as a reaction to conflict or potential conflict. Without the specter of conflict, there is no need to cooperate.” (1984, p. 54).

2.2. THE PUSH TOWARDS LEGALIZATION IN THE INTERNATIONAL ARENA

2.2.1. Brief Overview

International law does not operate in a vacuum. As a result, international treaties and commitments affect and are affected by other variables, reflecting the evolution of history. In the past, international law has focused on external sovereignty of governments, following a logic of state-centered international relations (Petersmann 1998, p. 179). As the dimension of international relations has changed, so has the approach to international law, giving way to a legal perspective that is citizen-oriented, fundamentally different from the power-oriented prevailing wisdom of the past. We have previously noted increasing cooperation as a result of an ever more interdependent world, and as such, there is a necessity for international law to provide a framework for greater integration. Such example is clear in the case of the European Union’s integration project, as the European Court of Justice played a major role in “propounding the legally binding character of both the Treaty of Rome and EU directives” (Goldstein et al 2000, p. 388). Actions taken as a result of the creation of

---

17 Professor Petersmann uses the term as to characterize the escape from “hobbesian insistence on sovereign rights of governments, border controls, mercantilist protection of domestic industries and nationalist discrimination against foreigners” (1998, p.179)
NAFTA, the International Criminal Court, the Law of the Sea Tribunal, the Montreal Protocol, among others, also speak of the move towards law and of the importance of such step (Goldstein et al 2000, p. 385-386).

Given the way that international law structures have flourished in the last few decades, it is interesting to examine the efficiency of such arrangements as to determine how strong and effective have they been. As noted by Goldstein et al, the process of legalization is hardly uniform, as compliance with international commitments is at best uneven. One possible reason for such phenomena is the absence of a global police as any of the international commitments cited require a degree of self-enforcement, thus allowing for the conclusion that even the most advanced international legal system will require a degree of politics.

2.2.2. Legalism and the WTO: A rules-based mechanism

The Dispute Settlement mechanism that was brought with the creation of the WTO in 1995 highlights the importance of the move towards law and away – albeit not entirely - from politics. This assumption is rather clear when one considers that in the previous years, under the GATT agreement, states that were parties to the Dispute Settlement mechanism in the GATT could unilaterally block implementation of an unfavorable decision – one of its “birth defects” (Jackson 2005, p.4) Moreover, even an unfavorable decision would be a rarity, as Articles XXII and XXIII of the GATT made sure to stress the necessity of a common understanding between the “contracting parties”. As common understanding is often impossible to find in a trade dispute, this was a major weakness of GATT dispute resolution procedures.

An international system of dispute resolution based on the rule of law is a novelty that holds great importance to the practice of international law and international relations, as it carries significant consequences. First, it marks a new definition of
sovereignty, by regulating matters that before were *exclusive domestic domains*, such as those relating to international trade – taxation, investment, subsidies, among others (Petersmann 1998, p. 179). *Second*, it shows a deviation from power and politics-oriented mechanisms of the past, as it allows a forum where less powerful countries can get favorable decisions against a more powerful one. *Third*, it creates jurisprudence with repeat application of law, strengthening the rules and regulations that nations should abide by and creating a set of expectations from international actors.

The effect of a rule-based mechanism in international economic law is quite visible when the WTO Dispute Settlement system is compared to other mechanisms of dispute resolution. Countries have made extensive use of the WTO’s Dispute Settlement procedures as opposed to older systems of resolution. Even when taken into consideration the different nature of the cases brought before the International Court of Justice and the WTO, in just ten years, the Dispute Settlement mechanism in the WTO has seen the submission of 335\(^{\text{18}}\) cases, in contrast to the approximately 115 cases that the International Court of Justice (ICJ) has seen since 1946\(^{\text{19}}\). While the WTO issues its own sanctions, the ICJ sends its cases to the United Nations Security Council in cases of non-compliance, a highly political chamber. Countries have often ignored ICJ decisions without as much as a “slap in the wrist”.\(^{\text{20}}\) Petersmann cites that despite explicit provisions determining the submission of intellectual property disputes to the ICJ, countries have chosen the WTO’s DS chambers along with its rules and procedures to conduct their disputes in intellectual property matters (1998, p.183), a prime example that a large majority of countries would rather recourse to and abide by the rule of law.

\(^{\text{18}}\) As of January, 2006.
\(^{\text{19}}\) Information based on the data available at [http://www.icj-cij.org/icjwww/idecisions.htm](http://www.icj-cij.org/icjwww/idecisions.htm)
\(^{\text{20}}\) Srulevitch (2004) has pointed out that the US, France and Iceland – have rejected ICJ rulings without consequences. Albania, Argentina, Guinea-Bissau, Iran, Malaysia, Morocco, Nigeria, Romania, and Thailand have all ignored ICJ rulings without incurring Security Council sanctions.
2.3. COMPLIANCE THEORY

Compliance theory, as briefly examined in the theoretical literature section, has evolved in connection to the evolution of the disciplines of international law and international relations and, more recently, has relied heavily in the interdisciplinary work between these two subjects. This being the case, the focus of the study at hand will be aimed at those strains of compliance theory that have resulted as an attempt to bridge international relations and international law.

Given the peculiarities of Dispute Settlement in the WTO, most notably the binding nature of its sanctions in form of retaliation, it seems most useful that this “enforcement” prescribed by the WTO DS be analyzed and, in order to do so, the best possible alternative seems to be to examine this school of thought separately and to compare the results with a school of thought that offers opposing ideas – the managerial theory of compliance. This thesis will also briefly outline what a complementary approach to compliance would look like, in light of the work of Tallberg and Raustiala.

In the next sections, we shall state what these different approaches prescribe, their possible differences and similarities, and their relation to Dispute Settlement in the WTO.

2.3.1. Managing compliance

The emergence of the managerial thesis of compliance marks the beginning of a dialogue between scholars from international relations and international law (Chayes & Chayes 1993, p. 176). Managerialists frame their theory in three key propositions: compliance with international agreements cannot be empirically verified, noncompliance does not necessarily reflect a rational calculation of interests and, finally, treaties should not be
subject to rigid, strict levels of compliance, but rather an overall acceptable level of obedience (Chayes & Chayes 1993, p.176).

The impossibility of empirical verification of respect to international agreements leads to the adoption of assumptions, which differ depending on the perspective on the issue – realist, normative, and managerial. It is possible to infer that herein lies the philosophical difference between strains of thought when it comes to compliance. Managerial views on compliance adopt the assumption that states have a propensity to comply. As shall be seen later, enforcement theorists do not. It is then of paramount importance to investigate where these assumptions originate and to examine the plausibility of such claims.

The logic behind the aforementioned assumption is rather simple. According to the managerial perspective (Chayes & Chayes 1993; 1995), states do not need to enter into agreements they do not want to sign. And if they do, this action of consenting means that their interests will be met, even if in the process of negotiating they cede ground. As a result, the constraints imposed by any international agreement reflect the expectation that other parties subject to the same agreement will feel similarly constrained (Chayes & Chayes 1993, p.187). Therefore, managerial proponents observe a clear link between treaty commitments and state interests, rejecting, when it comes to compliance with such commitments, “the assertion that states carry out treaty commitments only when it is in their best interest to do so (…)” (Chayes & Chayes 1993, p. 179).

Managerial advocates trace noncompliance occurrences to the ambiguity of international agreements (1), limitations of the parties in carrying out the commitment they undertook (2) and changes from the circumstances present when signing an agreement (3) (Chayes & Chayes 1993; Tallberg 2002, p. 613). These roots differ greatly from the rational behavior advanced by enforcement enthusiasts, as shall be seen. They also lead to a key

---

21 “How would Iraq’s unbroken respect for the borders of Turkey, Jordan, and Saudi Arabia count in the reckoning against invasions of Iran and Kuwait?” (Chayes and Chayes 1993, p.177).
22 Henkin argues that “the fact is that law observance, not violation, is the common way of nations” (1968, p.49)
concept surrounding management of compliance, namely, that of an acceptable level of compliance\textsuperscript{23}. Determining such acceptable level is perhaps the most difficult enterprise facing a managerial supporter, as it is a very subjective task, especially given the difference of opinions that countries might have about what is acceptable or not. Managerialists have been relatively silent about how to determine such an acceptable level, rather focusing on a case-by-case approach, trying to avoid a breaking point, in the words of Young (1999, p.85), when violations levels would become intolerable.

In light of their background assumptions and key concepts, management theory of compliance proposes enhancing rule interpretation, transparency and technical and financial assistance as a way of achieving better compliance standards (Young 1999; Chayes & Chayes 1995; Chayes, Chayes & Mitchell 1998).

\subsection*{2.3.2. The Enforcement School}

Whereas the managerial thesis of compliance is heavily influenced by work of international law scholars, those who support enforcement as a way of achieving better compliance in the international scenario provide what is also known as the political economy perspective in regards to compliance. Its bedrock is the assumption that states are rational unitary actors and that a decision to comply or not with an agreement is only taken after careful calculation of costs and benefits (Downs et al 1996; Tallberg 2002). Thus, whereas managerial prescriptions in regards to compliance are influenced by the assumption that states have a propensity to comply with international agreements, the enforcement view on compliance generates its conclusions from what Tallberg calls the incentive structure (2002).

\textsuperscript{23} Chayes & Chayes utilize the term as to put forth the idea that a violation of an agreement may be small or within a level that does not compromise the integrity of it (1993, p.197-198). Oran Young describes violation tolerance, in the same logic: “(…) there is a tendency in many discussions of compliance to start (…) by positing a standard of perfection and then to see sings of serious trouble on the horizon whenever this standard is not met (1999, p.84-85).”
The managerial claim that states have a propensity to comply is vigorously challenged by enforcement theorists, as they argue that this high compliance rate is vastly misleading because of *endogeneity* problems, which is to say that states choose which treaty to sign from various options, and in many occasions, settle for the lowest common denominator. In the view proposed by Downs *et al.*, as a result, such treaties do not require states to change the behavior they would have in the absence of an agreement (1996, p. 382-385).

Consequently, enforcement proponents establish a key element in their compliance theory, namely, *depth of cooperation, which refers to the extent it captures the collective benefits that are available through perfect cooperation in one particular policy area.*” (1996, p. 383), setting forth the claim there is a fundamental relation between the need for enforcement and the depth of cooperation on a certain area. To explain the connection between the depth of cooperation and the need for enforcement, Downs, Rocke and Barsoom cite the case of the GATT system, which evolved into deeper cooperation when of the creation of the WTO. In their view, this deeper cooperation would not have been possible without changes as to reduce self-interested exploitation by member states, to which the WTO’s DSU is an example (1996, p.392).

2.3.3. Enhancing compliance through a complementary approach

Managerial and enforcement theories of compliance offer different strategies for achieving their objectives. An attempt to challenge this assumption is made by Jonas Tallberg, in a work where he argues that, in order to achieve higher rates of compliance, managerial and enforcement mechanisms should be combined (Tallberg 2002, p. 610).

Tallberg dissects compliance instruments in the European Union, resulting in what he describes as a “management-enforcement” ladder. There are four stages to this
proposed ladder (Tallberg 2002, p. 633): preventive capacity-building and clarification of rules as to reduce violations due to incapacity (1); monitoring that enhances transparency and exposes violators (2); a legal mechanism that allows cases to be brought against violators and clarifies the interpretation of rules (3); sanctions as a last resort if states refuse to comply with decisions arising from the legal mechanism (4).

In applying the concept to Dispute Settlement and the WTO, his analysis is that managerial elements of the compliance system were reinforced by the introduction of some enforcement measures, although stressing that the WTO dispute-settlement system’s nature is that of compensation rather than punishment (2002, p.634).

2.4. ANALYTICAL FRAMEWORK: EXPECTATIONS AND TESTS

In the previous sections, attention was given to key concepts regarding theoretical and methodological aspects of the study at hand. It is in light of the methodological choices and theoretical propositions before presented that analysis is to be conducted, making it necessary to demonstrate the role of each analytical aspect and also to state what is to be expected when theories are tested in order to avoid a tautological proposition. Previously, the theories of compliance that will guide the work at hand were stated; it is now time to state what is to be found in case the hypotheses derived from the investigated theories are valid and what is to be inferred in case they are false, through careful analysis of the case-studies. What are the effects of retaliation? Does a rule-based mechanism induce compliance? How binding are the decisions of the WTO Dispute Settlement mechanism and what effects do they have on compliance? Does the WTO DS mechanism present an overall acceptable level of compliance, and if so, is that contaminated by problems of endogeneity? These questions and others are the driving force of this work and will be dissected through analysis of the available data on WTO dispute settlement.
If the managerial theory of compliance is correct, then it will be noted that enforcement plays a very minor in inducing compliance at the WTO and even so, is likely to be ineffective; that states have a propensity to comply with the WTO accession treaty that they signed; that a breaking point has not been reached; that non-compliance is inadvertent rather than a result of calculation of interests. As a result, to improve compliance the WTO should: improve procedural questions as to tackle the matter of ambiguity; increase transparency as to increase social and reputational pressure on violators of Appellate Body decisions as opposed to using coercive measures; promote capacity building through increase in technical knowledge and improvement in bureaucracy work.

In the other hand, should enforcement thinking prevail, it should be seen that enforcement is the key element in achieving compliance and that retaliation is not only effective, but desirable. It will also be noted that when states do not comply, this is a result of careful calculation of interests and, therefore, the solution to such problem is to increase retaliatory measures and trade sanctions. Also, if the WTO agreement is seen as a result of deep collaboration, then its enforcement mechanism must provide the necessary level of punishments in order to achieve compliance, as failure to do so would result in the breakdown of the enforcement’s theory of compliance logic.

By logical conclusion, should the managerial or enforcement thesis of compliance withstand the tests presented by the WTO Dispute Settlement system as set out in this research, the complementary hypothesis of compliance would be discarded as unnecessary. In the other hand, if managerial and enforcement theories of compliance do not achieve satisfactory results when applied to the WTO, a hybrid approach would have to be countenanced.
CHAPTER 3

COMPLIANCE AND DISPUTE SETTLEMENT UNDER THE WTO: IS THERE A PROBLEM?
There is no doubt that the creation of the dispute settlement procedures under the WTO marks a pivotal turn towards legalization in international economic relations. However, is this legal design effective and how do we assess its success or failure? In order to achieve such answers, it bears necessity to first establish what the aim and nature of the DS, for this definition will frame the consequent debate. In order to know if there is a problem, we first need to define what the purpose of the DSU is.

The lingering tension between those who believe the DS system should judge and those who believe the DS should promote settlement are well documented, as pointed out by Thortensen (2005). They are affected by the binding nature and rule-based environment that the WTO system created, with lawyers pushing towards law and diplomats doing the same towards negotiation. For the former, the solution is juridical, for the latter the solution is diplomatic.

Mindful of the impact of legalization and the context in which it flourished, the framework here presented will side with those who believe that the purpose of DS in the WTO is to settle disputes, inducing compliance in the process of doing so. To argue that the Dispute Settlement mechanism purpose is to judge trade disputes would seem to infer that it would have a mandate to carry out a “sentence”, which is not supported by evidence as countries may choose to be the subject of retaliation rather than modify their legislation. Furthermore, the existence and usage of originally legal aspects such as rule-based, binding decisions does not rule out the purpose of settlement, rather acting as a way to pursue it.

As to leave no doubt of the goal of Dispute Settlement in the WTO, attention must be turned to wording by the WTO itself, which states, regarding disputes, that “(...) the point is not to pass judgement. The priority is to settle disputes, through consultations if possible.” Article 3.4 of the Dispute Settlement Understanding suggests the same by stating

24 Available online at http://www.wto.org/english/thewto_e/whatis_e/tif_e/displ1_e.htm
that “(...) recommendations or rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter (...)”. Moreover, it shall be seen later that panel reports in the bananas and the aircraft cases specifically mention that countermeasures should be quantified as to effectively induce compliance. Should any doubt still linger, it is possible to infer that the ratio legis behind the DSU was to achieve settlement by inducing compliance as the understanding stipulates that a losing defendant can achieve compliance by only having to change legislation as to conform to WTO agreements, therefore not being subject to punitive sanctions.

3.1. WHAT DO THE STATISTICS SHOW? IS THERE MORE TO IT?

Reading and analyzing statistical evidence may often be misleading. A raw review of numbers might often conceal important data and relevant aspects. In light of that, first an opinion on available numbers will be provided, followed by critical analysis on what they might not show or conceal.

<table>
<thead>
<tr>
<th>NUMBER OF CASES TOTAL</th>
<th>RETALIATION ALLOWED</th>
</tr>
</thead>
<tbody>
<tr>
<td>335</td>
<td>15</td>
</tr>
</tbody>
</table>

*Fig. 3: Table on the number of cases where retaliation was allowed*

<table>
<thead>
<tr>
<th>NUMBER OF CASES TOTAL (%)</th>
<th>RETALIATION ALLOWED (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>4.48%</td>
</tr>
</tbody>
</table>

*Fig. 4: Table on the percentage of cases where retaliation was allowed*

Since the inception of the Dispute Settlement under World Trade Organization rules in January of 1995, there have been 335 complaints brought into the mechanism. Of

---

25 WTO document: WT/DS46/ARB: “3.44 (...) we note in this respect that the Article 22.6 arbitrators in the EC - Bananas (1999) arbitration made a similar statement. We conclude that a countermeasure is “appropriate” inter alia if it effectively induces compliance.”

26 The basis or reasoning for a law.

27 Figures taken from the WTO’s Update on Dispute Settlement Cases: WTO Document WT/DS/OV/26, of March 1, 2006.
those complaints, only 15 resulted in authorization for suspension of concessions. From a mere numerical analysis alone, only 4.48% of the disputes exhausted the whole dispute settlement procedure without settlement, which seems to indicate a very high level of compliance. This preliminary analysis would appear to point towards the managerial claim that states have a propensity to comply and that the overall acceptable level of compliance is high. Further scrutiny weakens these allegations, as shall be seen.

What the figures discussed do not show is that states might settle their disputes before the retaliatory phase because they might believe current enforcement procedures to be ineffective, which would give strength to the political economy theory of compliance’s assertion that state’s propensity to comply derive from endogeneity (1); the diverse importance given to different cases by countries as they might choose that some disputes are not worth “going to war for” – which has severe implications to the managerial proposition that violations must be contained within acceptable levels, as these 15 cases might present crucial, unacceptable issues for a country (2); political and economical pressure that might affect a country’s decision to carry on with a dispute should an asymmetrical economical relation be present, leading to the complainant country accepting much less than full compliance\(^28\) (3).

For the present analysis to corroborate these ideas it is essential that these 15 cases of noncompliance be investigated as to observe what effects they have on the compliance procedures as a whole. Although not numerically significant (15 out of 335), they may either substantiate the claims above or falsify them, with significant consequences to the propositions put forth by the managerial and enforcement theoretical approaches. A careful

\(^{28}\) Brimeyer (2001) argues that compliance is doubtful because of disagreement as to what full compliance entails. In this case, it appears that the settlement system must be given the benefit of the doubt. It would be extremely difficult, if not impossible, to empirically prove that states are pressured into some of the decisions they take. As a result, if states settle for less than full compliance, unless this action is a result of the system’s failure in distributing sanctions, the burden for such action is on the states who gave up legal recourse. The present study mentions this factor as to show that it is not oblivious to power asymmetries between countries.
examination of two of those 15 cases follows, as well as congruencies drawn from examination of all the cases.

3.2. NONCOMPLIANCE: WHEN THE SYSTEM FAILS.

3.2.1. The aircraft disputes between Brazil and Canada

Brazil and Canada are two of top ten countries in terms of number of complaints brought through the Dispute Settlement mechanism of the WTO, filing fewer complaints only than the United States and the European Communities\(^{29}\) (See Fig.5 below).

Their aircraft disputes under the umbrella of the WTO’s Dispute Settlement carries considerable importance to the issue of compliance as it marks an issue area (aircraft industry) of “highly important (both politically and economically) interests in each of the disputing

\(^{29}\) The European Union is, for legal reasons, called European Communities, in WTO disputes. This research will refer to is as such.

\(^{30}\) Figures were based on the information available online at:
http://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm
countries” (Behboodi 2001, p. 387). In such scenario, the hypotheses provided by the managerial and enforcement perspectives on compliance find an important test. What is the compliance record left by the WTO DSM in a dispute marked by such sensitivity? The answer to this question is of great importance to the schools of compliance that are scrutinized in the present research.

3.2.1.1. Canada vs. Brazil

The whole imbroglio between Canada and Brazil as regard to aircrafts originates in the last decade as a result of increasing demand for regional jet aircrafts (Behboodi 2001; Sullivan 2003), an industry dominated by Canada’s Bombardier and Brazil’s Embraer.

About 10 years ago, in June of 1996, Canada opened consultations with Brazil as to its belief that the Brazilian PROEX was a de facto prohibited subsidy, in violation of obligations undertaken in light of the Agreement on Subsidies and Countervailing Measures (SCM), which is one of the covered agreements under the spectrum of the WTO. After roughly two years of attempts to settle the dispute outside the WTO (Behboodi 2001, p. 390), the countries referred the matter to a WTO Dispute Settlement panel which deemed the PROEX program to be in violation of WTO agreements, in April of 1999, a decision upheld.

---

31 Canada’s Bombardier is one of the country’s biggest companies (No. 25, according to Forbes) whereas Embraer was Brazil’s largest exporter from 1999 to 2001 and second largest in 2002, 2003, and 2004 (www.embraer.com/english/content/empresa/profile.asp). The issue is of deep sensitivity for Brazil as in the eyes of the Brazilian Government, PROEX’s goal was to create a level playing field since interest rates in Brazil are amongst the higher in the world and Brazil bears the burden of being a developing country (dubbed Brazil Risk), which in itself carries increased costs of financing.

32 “Embraer and Bombardier share the market for regional jets, just as Boeing and Airbus have split the big-plane business.”, available online at: http://money.cnn.com/magazines/fortune/fortune_archive/2005/11/14/8360683/index.htm

33 Brazil – Export Financing Programme for Aircraft, WTO document: WT/DS46

34 PROEX is described by the Brazilian Government as an interest rate equalization programme that equalizes the cost of financing on exports of covered Brazilian products to international levels.

35 WTO document: WT/DS46/R – “8.1. In conclusion, we find that:
by the Appellate Body in August of the same year. This is the background information in order to understand the dynamics of what happens in the compliance phase. Brazil was found to be in violation and now it was time to comply. Did it? Hardly. Brazil failed to implement the Appellate Body decision and although it established changes to the PROEX program, these changes were again found to be in nonconformity to WTO agreements, according to the decision of a Compliance Panel (Article 21.5) in July of 2000. This decision led to the authorization of suspension of concessions in the following month, to the extent of US$ 233 million dollars a year for a period of six years.

Brazil’s decision not to comply seems to be far from the managerialist assertion that noncompliance is not a result of a deliberate, thought-out process carried out – in this case – by the Brazilian Government. This much was stressed by a high-ranking Brazilian official who said that the goal of pursuing dispute settlement procedures was to ensure that Embraer kept its market on regional aircraft. More so, considering the importance attributed to the case by the countries in dispute, Brazil’s noncompliance appears to give strength to the

(a) PROEX interest rate equalization payments on exports of Brazilian regional aircraft are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon export performance within the meaning of Article 3.1(a) of that Agreement;
(b) PROEX interest rate equalization payments on exports of Brazilian regional aircraft are not "permitted" by reason of the first paragraph of item (k) of the Illustrative List of Export Subsidies;
(c) Brazil has failed to comply with certain of the conditions of Article 27.4 of the SCM Agreement and the prohibition of Article 3.1(a) of the SCM Agreement is therefore applicable to Brazil.”

36 WTO document: WT/DS46/AB/R – “197. (…)In this respect, we recall that we uphold the recommendation of the Panel that Brazil shall withdraw the export subsidies for regional aircraft under PROEX within 90 days.”

37 It must be reiterated that only the basic, key elements of the case are being presented and described. The panel and appellate body report contain about two hundred pages, dealing with a range of issues that although important to WTO law are deemed to be not relevant to present research.

38 WTO document: WT/DS46/AB/RW – “82 (b). upholds the Article 21.5 Panel’s findings that payments made under the revised PROEX are prohibited by Article 3 of the SCM Agreement, and are not justified under item (k) of the Illustrative List, and therefore upholds the Article 21.5 Panel’s conclusion that Brazil has failed to implement the recommendation of the DSB that it withdraw the export subsidies for regional aircraft under PROEX within 90 days.”

39 WTO document: WT/DS46/ARB – “4.1. For the reasons set out above, the Arbitrators decide that, in the matter Brazil – Export Financing Programme for Aircraft, the suspension by Canada of the application to Brazil of tariff concessions or other obligations under GATT 1994, the Agreement on Textiles and Clothing and the Agreement on Import Licensing Procedures covering trade in a maximum amount of C$344.2 million per year would constitute appropriate countermeasures within the meaning of Article 4.10 of the SCM Agreement.”

40 Interview in São Paulo on June 18, 2005.
enforcement proposition that noncompliance results from a rational calculation of interests (as opposed to the managerialist view that noncompliance may be inadvertent) and that a deep collaborative agreement such as the WTO would need to rely on the threat of sanctions to prevent shirking from obligations. In addition, a study of the aforementioned case is also supportive of the enforcement approach’s critique of managerialism’s *propensity to comply* belief, as in this case, no such propensity was found.

Another matter is the appropriateness of sanctions available in the WTO agreement. This question will be discussed at length in the next chapter but it is worth noting, having received the right to retaliate, Canada did not do so. As Behboodi, counsel for Canada at this dispute, writes (2001, p. 401), should this retaliation be exercised, Brazilian imports of certain commodities would be affected and the subsidies, which were the reason that drove Canada into filing a complaint, would remain. Even a *quasi-judicial*, binding mechanism such as the Dispute Settlement presented in the WTO has limitations, and the opportunistic exploitation of the mechanism by Brazil in this case could not be avoided.

Having noted the calculated action taken by Brazil in this case, which resulted in immediate noncompliance, eventually (six years after Canada first questioned the Brazilian interpretation of WTO agreements), Brazil was found to have corrected its PROEX program with the implementation of PROEX III\footnote{Decision of Article 21.5 panel in July 21, 2001, in WTO document WT/DS46/RW/2: “63. For all of the reasons given in Brazil’s First Submission and in this Submission, the Panel should conclude that:
(a) Canada has not sustained its burden of proving that PROEX III is a subsidy within the meaning of Article I of the SCM Agreement;
(b) Alternatively, even if PROEX III were considered to be a subsidy, it complies with the interest rates provisions of the relevant OECD Arrangement and is, therefore, covered by the “safe haven” of item (k) second paragraph;
(c) Further, even if PROEX III were considered to be a subsidy, and even if it were not eligible for the safe haven of item (k) second paragraph, PROEX III is not used to secure a material advantage in the field of export credit terms within the meaning of item (k) first paragraph.”} At last, compliance was achieved and we will examine the implications of such *foot-dragging* strategy by Brazil at a later stage. Was fear of retaliation behind Brazil’s decision to comply? Was it fear of reputational damages? Was the
language of the agreement too ambiguous? These questions, which are key to investigating the opposite theories of compliance, will be addressed in later sections and in Chapter 4.

3.2.1.2. Brazil versus Canada

Following Canada’s complaint in the WTO, Brazil filed a case against Canada in January of 2001, arguing that Canada was granting subsidies to its regional aircraft industry\(^\text{42}\), as a way of matching subsidies that were not authorized by any WTO agreement. The first Panel agreed with that assessment\(^\text{43}\), with a decision that was not challenged by the Canadian government. Canada was then expected to comply with the Panel ruling, doing away with its disputed subsidy in 90 days, which it did not\(^\text{44}\). As a direct consequence, Canada was in noncompliance with the decision of the WTO Dispute Settlement mechanism and Brazil was, as a result, given the right to retaliate to the amount of US$ 247 million\(^\text{45}\), which it – similarly to Canada’s previous decision – has not yet exercised.

---

\(^{42}\) WTO document WT/DS222/1 : "(...) All of the above-mentioned measures are subsidies, within the meaning of Article 1 of the Subsidies Agreement, since they are financial contributions that confer a benefit. They are also contingent, in law or in fact, upon export, and constitute, therefore, a violation of Article 3 of the Subsidies Agreement.”

\(^{43}\) WTO document WT/DS222/R: “8.1. (e) uphold Brazil’s claim that the EDC Canada Account financing to Air Wisconsin constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement; (f) uphold Brazil’s claim that the EDC Canada Account financing to Air Nostrum constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement; (g) uphold Brazil’s claim that the EDC Corporate Account financing to Comair in July 1996, August 1997 and February 1999 constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement;”

\(^{44}\) WTO document WT/DS222/ARB: “3.106. In the present case, we asked Canada to clarify whether it actually did not intend to comply with the DSB recommendations. Canada confirmed that it would honour its contractual commitments to grant the financing found to be an illegal subsidy on the aircraft undelivered as of the compliance date. We take this statement to mean that Canada does not now intend to withdraw the subsidy at issue, as is required pursuant to Article 4.7 of the SCM Agreement.”

\(^{45}\) WTO document WT/DS222/ARB: “4.1 For the reasons set out above, the Arbitrator determines that, in the matter Canada - Export Credits and Loan Guarantees for Regional Aircraft, the suspension by Brazil: (a) of the application of the obligation under paragraph 6(a) of Article VI of GATT 1994 to determine that the effect of subsidization under EDC Canada Account and EDC Corporate Account programmes is to cause or threaten material injury to an established domestic industry, or is to retard materially the establishment of a domestic industry; (b) of the application of obligations under the Agreement on Import Licensing Procedures relative to licensing requirements on imports from Canada; and
As discussed before, the enforcement approach on compliance draws many of its key elements from the assumption that states are rational unitary actors and in strategies that are typically derived from game theory. In this case it seems transparent that Canada used a “tit for tat” strategy and the end result was successful since it was able to shirk from the system without paying any price but a reputational one. Also, the use of a tit for tat strategy explicitly discards the managerial proposition that noncompliance is inadvertent. This kind of counter-dispute between the two countries also carries notable effects to compliance with the system as whole, since the other 146 countries in the Organization expect these two countries to comply and are affected by their political calculation not to.

The idea that compliance is a political calculation (Appleton; Flores; Pannatier) as inferred from the two cases above exposes a critical problem of the managerial hypothesis as well as a clear limitation as to what can legalization achieve as the backbone of the WTO’s Dispute Settlement system. These characteristics wield considerable pressure on the enforcement procedures of the mechanism, which, in these particular cases, proved incapable of accomplishing prompt and full compliance. Having established that, it is worth noting that, after initial defiance of the system, both countries entered into a slow, gradual path towards compliance. This seems to support the idea that retaliation, even when not carried out, serves as an inducement for compliance, as a result of reputational considerations.

(c)of tariff concessions and related obligations under the GATT 1994 concerning a list of products to be drawn from the list attached to its request; covering trade in a total amount of US$247,797,000 would constitute appropriate countermeasures within the meaning of Article 4.10 of the SCM Agreement.”

46 Roughly described, a tit for tat strategy in game theory requires that agent A cooperates if B does so and also that it retaliate in an equivalent amount should agent B not cooperate (Axelrod 1984).

47 Interview given in Geneva on October 22, 2005.

48 Interview given in Rio de Janeiro on June 19, 2005.

49 Interview given in Geneva on October 28, 2005.
typical of iterated games\textsuperscript{50}, such as the one played in implementation of WTO Dispute Settlement decisions.

3.2.2. The Bananas Case

The origin of the Banana Case in the WTO lies in the need for policy integration in the European Communities in 1993, with the creation of a single common market and a European Communities Banana Regime which had the goal of unifying various different import policies found in individual countries (Brimeyer 2001, p. 148; Josling 2003, p.169). Such policy integration resulted in the adoption of import licenses that were seen as discriminatory by Central American banana producers, as it established preferential treatment to former European Colonies.

Ecuador\textsuperscript{51} and the United States\textsuperscript{52} filed a complaint in the WTO about this discrepancy in treatment in February of 1996\textsuperscript{53}, challenging the European import policy and requesting that it be modified. A panel was convened and found in favor of the complainants in May of 1997\textsuperscript{54}, a decision that was reaffirmed by the Appellate Body in September of the

\textsuperscript{50} In iterated games, it is assumed that is unrewarding in the long run to defect, as multiple-play allows for retribution and reputational effects to come into play (Keohane 1984, p.75-76; Axelrod 1984).

\textsuperscript{51} Ecuador is the world’s largest producer of Bananas, accounting for roughly 35% of the World’s market (Paggi & Spreen 2003, p. 11)

\textsuperscript{52} The United States is not a major banana producer but is home to multinationals which explore banana production in Latin American countries.

\textsuperscript{53} Guatemala, Honduras and Mexico also participated as complainants. The choice to limit the compliance analysis to Ecuador and the United States reflects the fact that these other three countries were producers of dollar bananas – an expression commonly used to refer to those bananas produced in the conditions set out by note 50. As such, only the United States and Ecuador went through the whole dispute settlement process, all the way up to the retaliation phase.

\textsuperscript{54} WTO document WT/DS27/R/ECU: “9.1 The Panel concludes that for the reasons outlined in this Report aspects of the European Communities’ import regime for bananas are inconsistent with its obligations under Articles I:1, III:4, X:3 and XIII:1 of GATT, Article 1.2 of the Licensing Agreement and Articles II and XVII of the GATS. These conclusions are also described briefly in the summary of findings.

9.2 The Panel recommends that the Dispute Settlement Body request the European Communities to bring its import regime for bananas into conformity with its obligations under GATT, the Licensing Agreement and the GATS.”
same year\textsuperscript{55}. Given the Appellate Body decision, the European Communities was then expected to comply with the ruling by modifying its Banana regime so that it became in conformity with WTO agreements. However, a compliance panel requested by Ecuador found, in April of 1999, that the European Communities were still not complying with the Appellate Body decision\textsuperscript{56}. That decision led to authorization for suspension of concessions (retaliation) by Ecuador\textsuperscript{57} and the United States\textsuperscript{58} in regard to the European Communities, up to the amount of US$ 201 and US$ 191 million, respectively. This was the first time in WTO procedures that retaliation was authorized.

The significance and lessons learned from the Bananas case are several. At first, it is essential to draw a parallel between the political-economical importance of the aircraft cases and the Bananas case. In these two occurrences of noncompliance, the issues at stake were of crucial political and economical importance to the parties at hand – in this case, the

\textsuperscript{55} WTO document WT/DS27/AB: “The foregoing legal findings and conclusions uphold, modify or reverse the findings and conclusions of the Panel in Parts VII and IX of the Panel Reports, but leave intact the findings and conclusions of the Panel that were not the subject of this appeal. The Appellate Body recommends that the Dispute Settlement Body request the European Communities to bring the measures found in this Report and in the Panel Reports, as modified by this Report, to be inconsistent with the GATT 1994 and the GATS into conformity with the obligations of the European Communities under those agreements.”

\textsuperscript{56} WTO document WTO/DS27/RW/ECU: “7.1 The Panel concludes that for the reasons outlined in this Report aspects of the EC’s import regime for bananas are inconsistent with the EC’s obligations under Articles I:1 and XIII:1 and 2 of GATT 1994 and Articles II and XVII of GATS. We therefore conclude that there is nullification or impairment of the benefits accruing to Ecuador under the GATT 1994 and the GATS within the meaning of Article 3.8 of the DSU.

7.2 The Panel recommends that the Dispute Settlement Body request the European Communities to brings its import regime for bananas into conformity with its obligations under the GATT 1994 and the GATS.”

\textsuperscript{57} WTO document WTO/DS27/ARB/ECU: “173.Consequently, and consistent with past practice in arbitration proceedings under Article 22,58 we suggest to Ecuador to submit another request to the DSB for authorization of suspension of concessions or other obligations consistent with our conclusions set out in the following paragraphs:

(a)Ecuador may request, pursuant to paragraph 7 of Article 22, and obtain authorization by the DSB to suspend concessions or other obligations of a level not exceeding US$201.6 million per year which we have estimated to be equivalent within the meaning of Article 22.4 to the level of nullification and impairment suffered by Ecuador as a result of the WTO-inconsistent aspects of the EC import regime for bananas.

\textsuperscript{58} WTO document WTO/DS27/ARB: “8.1. In light of the foregoing considerations, the Arbitrators determine that the level of nullification or impairment suffered by the United States in the matter European Communities - Regime for the Importation, Sale and Distribution of Bananas is US$191.4 million per year. Accordingly, the Arbitrators decide that the suspension by the United States of the application to the European Communities and its member States of tariff concessions and related obligations under GATT 1994 covering trade in a maximum amount of US$191.4 million per year would be consistent with Article 22.4 of the DSU.”
European preferential treatment of former colonies and the major economic activity of a country were at stake. If noncompliance is a trend in politically and economically charged cases and not individual occurrences in the selected cases, an important conclusion is drawn, not only about theories of compliance but also about the limitations of a quasi-judicial settlement mechanism. In the next section, congruencies will be searched in other cases of noncompliance to substantiate this important claim. In addition, the Bananas case also appears to corroborate the idea that compliance is a political calculation – strengthening the political economy perspective - and noncompliance results from a rational choice, as the European Communities has had every chance and planned to implement a tariff-only policy only in 2006\(^59\), ten years after the initial consultations.

Whereas managerialists argue that “sanctioning authority is rarely granted by treaty, rarely used when granted, and likely to be ineffective when used” (Chayes & Chayes 1995, p.32-33), it has already been established that the enforcement approach does not envision a complex collaboration process without sanctioning and enforcement tools. In the present case, the United States decided to carry out retaliatory measures, whereas Ecuador did not do so. The different paths followed by the United States and Ecuador in the implementation of the Arbitrator’s decision to allow for suspensions of concessions are directly related to the fundamental differences between the two countries. Whereas the United States constitutes Europe’s largest trade partner\(^60\), Ecuador accounts for only 0,1% of all imports by the European Communities\(^61\). In turn, the European Communities is responsible for roughly 13.1% of Ecuador imports in the amount of € 748 million and 19.6% of the

\(^{59}\) Even so, the designed plan to implement a tariff-only system was rejected by a WTO arbitrator in September of 2005, as Latin American countries were not satisfied with the concessions made by the European Communities, which fell short of full compliance. (European Commission Press Release, Ref: EC05-355EN available online at [http://europa.eu.int/articles/en/article_5212_en.htm](http://europa.eu.int/articles/en/article_5212_en.htm))

\(^{60}\) Source: Eurostat, Report of the DG of Trade of June 2005

\(^{61}\) Source: Eurostat, Report of the DG of Trade of June 2005
United States imports, in the amount of € 232 billion\textsuperscript{62}. Achieving compliance, in this backdrop, thus becomes a very different endeavor for the alluded parties. The United States promptly began to retaliate against the European Communities, imposing 100% duties in selected European exports\textsuperscript{63}, whereas Ecuador used its retaliation rights to impose reputational damages to the European Communities in order to pursue compliance.

In the next chapter further investigation as to why countries decide to retaliate or not will be conducted but, for now, it is clear that the retaliatory rights given to Ecuador were fundamental into pushing the European Communities towards policy-changes which, albeit short of \textit{full compliance}, constitute key advances in comparison to the existing policies before the filing of the complaint. Such event has major theoretical implications, as the threat of retaliation combined with reputational damages derived from noncompliance might prove to be a powerful tool of compliance inducement. If Ecuador could not pursue retaliation against the European Communities due to the asymmetry of their economic relations, the effects that such asymmetrical relations have on the issue of compliance are immense, as countries in the same position as Ecuador has found itself in this case would have only reputational pressure to rely on.

Regardless of the paths to compliance that were chosen by these very two different complainants, the record shows that the European Communities engaged in serious negotiations with the countries and was compelled to modify its Banana import regime. If \textit{full compliance} was expected - in the way of complete agreement with the dispute settlement’s decision to recommend that the European Communities should bring their norms in conformity to WTO agreements – then the expectations fell short. However, as is in the nature of negotiations, both sides must give up something in order to achieve a satisfactory result and a WTO Dispute Settlement decision has shown to be a powerful bargaining instrument

\textsuperscript{62} Source: Eurostat, Report of the DG of Trade of June 2005
\textsuperscript{63} Office of the United States Trade Representative Press Release of July 1, 2001.
(Andersen⁶⁴, Behboodi⁶⁵, Duran⁶⁶), something duly recognized by Ecuador (Pierola⁶⁷, Abdo⁶⁸). As a result, the importance of this highly significant enforcement tool should be acknowledged, lending strength to the enforcement perspective on compliance.

3.2.3. Congruencies in noncompliance cases

The analysis has so far presented relevant congruencies to the research at hand, namely the fact that in every case: these noncompliance episodes reflect instances of critical political and economical importance to the parties at hand (1); noncompliance was a political calculation (2); after initial noncompliance, the parties evolved in a gradual path towards compliance, however short of full compliance (3); the limitations of a quasi-judicial system were exposed as incapable of impeding opportunistic exploitation of the system by the countries (4); the decision from the WTO Dispute Settlement mechanism proved to be an important tool of compliance inducement(5).

In analyzing other instances of noncompliance, these congruencies gather even more strength. Politically and economically important issues arise in cases where noncompliance is present such as in the Hormones case, where Canada and the United States filed a complaint against the European Communities⁶⁹; the Foreign Sales Companies - FSC case⁷⁰, where the European Communities filed a complaint against the United States; the Byrd Amendment case⁷¹, a joint complaint by Australia, Brazil, Chile, European Communities,
India, Indonesia, Japan, Korea and Thailand (WT/DS217), and Canada and Mexico (WT/DS234), against the United States.

Changes to domestic legislation in order to pursue compliance are present in the FSC case, when following the WTO’s DS decision the US enacted the Jobs Act 72; in the Byrd Amendment case, where after arbitration awards were distributed, the US government signed the Deficit Reduction Act in early 2006 73; in the Salmon case brought by Canada against Australia, in which the latter was found to be in noncompliance in its implementation of a previous panel decision, prompting the two countries to achieve a satisfactory compromise even before the imposition of retaliatory measures (McGivern 2002, p. 146).

The limitations of a quasi-judicial system of dispute settlement are evidenced by the existence alone of the 15 noncompliance cases as previously mentioned, whereas the importance of a favorable noncompliance decision and the consequent right to retaliate are directly related to the changes in domestic legislation in a gradual pursuit of compliance as set out in the paragraph above. That noncompliance is a political calculation is harder to prove, as it is a common feature of international politics to keep noncompliance as silent as possible and tout every attempt of compliance as an enormous sacrifice and undertaking performed by a government. However, interviews conducted with several high-ranking officials in different

---

72 The legislation was found not to be in accordance to full compliance as recommended by the original panel. In this sense decided the second compliance panel (WT/DS108/RW2): “8.1 In light of the findings contained in Section VII above, we conclude that, to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through the transition and grandfathering measures at issue, it 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 under the relevant covered agreements.”

73 WTO document WT/DS/OV/26, p.189: “At the DSB meeting on 17 February 2006, the United States stated that the US Congress had approved the Deficit Reduction Act on 1 February 2006 and the President had signed the Act into law on 8 February 2006 bringing the US into conformity with its WTO obligations. Australia; Brazil; Canada; Chile; Indonesia; Hong Kong, China; India; Japan; Korea; Mexico; Thailand and the European Communities welcomed the recent steps taken by Congress towards the repeal of the CDSOA but disagreed with the United States that it had brought its measures fully into conformity with the DSB’s recommendations and rulings.”
countries and expert practitioners in the field of dispute settlement point, without a doubt, towards such conclusion. It should be observed that a gradual shift from noncompliance to compliance might result from a desire to appease a country domestic’s contingent (Andersen\textsuperscript{74}, Pannatier\textsuperscript{75}) – who benefit from opportunistic exploitation of the system.

All the aforementioned inferences from the analytical investigation conducted beforehand lead this investigation to assert the idea of a compliance pendulum (Fig. 6)\textsuperscript{76} between the legal and political aspects of dispute settlement in the WTO.

While the Dispute Settlement mechanism procedures until a decision is reached are characterized by a strict legal nature, after a decision is made, the implementation stage is typified by its political dimension, considered that abiding by the decision requires self-enforcement. Thus, compliance lies in between these two sides of the spectrum. The beginning of a dispute carries the pendulum to the legalistic aspect of the settlement mechanism, where discussions of rights and laws will be conducted and a decision will be reached. Until the end of that phase, there is no discussion of compliance as defined by this research, since a decision has yet to be reached. After a decision has been reached, the

\textsuperscript{74} Interview given in Geneva on October 21, 2005.
\textsuperscript{75} Interview given in Geneva on October 24, 2005.
\textsuperscript{76} Adam Watson, in his Evolution of International Society (1992), describes the changes of the international society between hierarchy and anarchy through the use of a pendulum. The idea of a pendulum between legalism and politics, although targeting issues very different than those described by Watson, is certainly inspired on his work.
pendulum swings to the political side where a decision to comply or not to comply is made. Should a decision to fully comply be made, the pendulum finds its equilibrium in the middle, as the systems effectively achieves compliance. In case a decision not to comply is made, the evidence here presented in the form of the case studies shows that the pendulum gradually makes its way towards the middle, even if it never reaches that point – of full compliance. A third alternative would be for a situation of never-ending defiance of a decision, in which the pendulum would remain in the political side of the spectrum.

3.3. IS THERE A PROBLEM WITH COMPLIANCE?

In the conducted analysis, it was possible to narrow down noncompliance as defined in this research to 15 of 335 cases, or roughly just fewer than 5% of the cases. In this scenario, Henkin’s (1968, p. 46-48) observation – which was later taken up Chayes and Chayes (1993, p. 177) – of the difficulty of counting violations against the number of occasions nations have respected treaties does not ring true, a direct consequence of the way compliance was defined in this research. In virtue of their assertion of states’ propensity to comply, managerialists would claim – and rightfully so – that this assertion is supported by the evidence amounted in the WTO’s Dispute Settlement mechanism as noted above. A 95% rate of compliance in the system as a whole is strong evidence of this. However, what also seems apparent is the enforcement’s approach to compliance contention that this high rate of compliance is a result of shallow collaborative action. The analysis on noncompliance examples demonstrates that states have a propensity to comply, unless the cases brought upon dispute settlement procedures are of crucial economical and political importance to the countries involved. The evidence has shown that in such a scenario, countries tend to shirk from their commitments, even if temporarily.
This temporal dimension of noncompliance brings up the question of why a decision for noncompliance would be provisional and not definitive. As previously seen, in accordance with the enforcement approach to compliance, in order to achieve success in scenarios where the depth of cooperation is great, punishment is necessary to prevent states from shirking from their obligations. The remedy prescribed by the WTO in noncompliance occurrences, retaliation, is, without a doubt, a punishment which purpose is to induce compliance in the system as a whole. The evidence derived from this analysis demonstrates that the pursuit of retaliatory measure is effective in inducing compliance, as in the majority of cases where noncompliance occurs, a gradual shift towards compliance is noted in the aftermath of decisions by compliance panels (Article 21.5 of the DSU) in which noncompliance was found to have occurred. What demands more scrutiny is the question of whether retaliatory measures can stand on their own as compliance-inducing or that collateral effects of retaliation such as reputational damages are the cause of the shift towards compliance. This question will be addressed in the next chapter, providing insight on whether enforcement is preferred to management of compliance.

Finally, it should be noted that when analyzing if there is a compliance problem in the WTO, no definitive answer seems to arise, as different actors and scholars might have a different opinion on what violations mean. Ecuador, which was on the receiving end of noncompliance in one of the only three complaints it has filed (Bananas Case), could have a completely different opinion than the United States, for example, which has filed more than 80 complaints with different levels of success (see Fig. 3, Footnote 29). However, this debate should not be conducted in the absence of consideration for the important legalizing procedures that are peculiar to WTO dispute settlement. The very existence of this legal procedures ensure that a hobbesian view on international politics can be discarded and that a

77 WTO document WT/DS/OV/26
country like Ecuador, completely asymmetrical in regards to its economic relations with the European Communities, can file a complaint and achieve relative success in such legalistic environment. The mere existence of a procedure to settle trade disputes is a significant step in international cooperation; the solving of compliance problems derived from such procedure would denote great effort by the parties involved to take this cooperation a step further.
CHAPTER 4

RETALIATION (OR LACK THEREOF) UNDER THE WTO
4.1. THE LOGIC OF RETALIATION

The suspension of concessions (retaliation) is the ultimate enforcement tool in the WTO Dispute Settlement procedures. By investigating how it is used and whether it achieves its purpose (inducing compliance), important theoretical considerations will arise as a test to both managerial and enforcement approaches to compliance. Is this coercive tool ineffective as a way of achieving higher compliance rates, as in the managerialist view or is it essential for such an objective, as prescribed by the proponents of enforcement? In this chapter, the study analyzes the relation between economic asymmetries and the logic of retaliation, the reasoning for applying retaliatory measures (or not) and the effects of the use of retaliation in achieving compliance.

Most systems of law prescribe the need for punishment as a coercive measure to maintain discipline and respect to legal frameworks. In most domestic courts, a typical sentence would require a “law-breaker”, for instance, to serve time in prison, or to repay money unlawfully obtained. In a legalized environment such as the WTO’s dispute settlement, as already established, the implementation phase is characterized by an escape from legalistic procedures and a dominance of political considerations. As a result, it ought to be observed that WTO’s “sentences” are in fact recommendations\textsuperscript{78}. Failure to follow these recommendations, may lead, ultimately, to retaliation.

The use of retaliatory measures are prescribed in the Dispute Settlement Understanding with the purpose of inducing compliance but also with the aim of imposing equivalent economic losses to the noncompliant country\textsuperscript{79}, seeking a rebalancing of economic

\textsuperscript{78} Recommendations are the way the Dispute Settlement Understanding describes the decisions made by the Panel and by the Appellate Body.

\textsuperscript{79} Article 22.4 of the DSU states that “The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment.”
relations. However, the practice has shown that exercising retaliation does not achieve such goal, and that this rebalancing is in fact a myth (Anderson 2002; Spamann 2006), since retaliation, by purely economic logic, results in the raising of import tariffs that hurts not only the countries involved in the dispute but also third countries (Anderson 2002, p. 5; Bièvre 2002, p. 1011). The idea that, from an economic perspective, retaliation promotes trade-distortion\(^80\) is a key concept that has direct effects to the issue of compliance, as will now be examined.

4.1.1. Statistical Analysis on Retaliation

As shown in the third chapter (Figs.3 and 4) there have been so far 15 occasions where retaliation rights were awarded to complainant countries. To begin the investigation of the effectiveness of retaliation as enforcement, it is important to analyze the number of times retaliation was actually carried out\(^81\), in comparison to these 15 occasions. Said analysis will make it possible to infer important information as to the relation between economical asymmetries and retaliation, as well as its effects on compliance. The chart presented below (Fig. 7) brings to light the retaliation decisions made on the 15 disputes that ended up in authorization for the suspension of concessions.

\(^80\) According to the WTO glossary, distortion occurs when “(...)prices and production are higher or lower than levels that would usually exist in a competitive market.” WTO Glossary, available online at: http://www.wto.org/english/thewto_e/glossary_e/glossary_e.htm

\(^81\) By the number of times retaliation was carried out, this research notes as such, every occasion when a restriction to trade was imposed based on the retaliation rights granted by the DSB. Thus, it may or may not include instances where retaliation was imposed at a much lower level than authorized by the DSB.
The Chart presented in Figure 6 shows that all disputes that resulted but those related to the Aircrafts case have the United States or the European Communities as a respondent, which seems to suggest that noncompliance is more visible in those two trade giants. Another observation is that in every decision that involved the EC and the US against each other – with the exception of the Copyright case, which involved a modest amount – retaliation ensued, which appears to indicate that these two actors have no problem using retaliation. All the listed countries either as complainants or respondents with the exception of Ecuador are present in the list of the fifteen largest economies in the world. Finally, it is worth mentioning that only one of the 15 disputes in which retaliation authorization was given involved a developing country (Mexico) retaliating against a developed one, something that will be the subject of more scrutiny in the next section.

---

82 The Arbitrator’s formula for calculating the amount of suspension of concessions prescribes imposing countermeasures on an annual basis in an amount equal to 72% of Byrd Amendment disbursements.

83 The information contained in this table is a result of individual analyses of official WTO information regarding the listed disputes.

4.2. COMPLIANCE AND ECONOMIC ASYMMETRIES

After some initial considerations about information contained in the retaliation chart above (Fig. 6), it is possible to observe a likely relation between the use of retaliation and the size of a country's economy. Does this indicate a developing/developed country perspective to the issue of compliance in the WTO, derived from substantial economic asymmetries? All evidence seems to suggest that economic asymmetries play a part in inducing and/or achieving compliance in the framework of the WTO as it does in probably all areas of international relations, something echoed by the officials and practitioners interviewed for this research. The reason for such development is that, although regulated by specific rules, the WTO Dispute Settlement affects and is affected by other aspects of international affairs. However, the use of the term *developing countries* would seem out of place in this context, since, as seen on the retaliation chart (Fig. 6), with the exception of Ecuador, every country in the list constitutes a major economy, and is thus able, in some circumstances, to carry out strategic suspensions of concessions.

The assertion that a *small* developing country would face difficulties in carrying out retaliation is of more value, but the same would hold true for New Zealand, a *small* developed country. Consequently, it is possible to ascertain that, when it comes to retaliation, economic size matters. Does the effectiveness of retaliation diminish when economic asymmetries are present? Most likely. As will be observed in the next sections, the capacity to implement the suspension of concessions is influenced by the size of a country’s economy.

The use of retaliation as a threat, the equivalent to holding a bargaining chip, is another dynamic of the implementation process. If an asymmetrical relation is present, how can the threat of retaliation be considered credible? 85 (Schelling 1960, p. 35-43; Lebow 1996, Lebow uses this very easy example: "(...) when my younger son threatens to leave home if he cannot watch his favorite television program, I laugh").
In pursuit of compliance: Lessons from the WTO’s Dispute Settlement Mechanism

p. 93), an essential element for achieving success through the use of threats? Even more troublesome is the fact that if a threat to retaliate fails, there is no other choice in the Dispute Settlement mechanism but to accept the other party’s best offer (Lebow 1996, p. 101), resulting in a complete inversion of roles, as the noncompliant party might offer a “take it or leave it” proposal.

4.2.1. WHY RETALIATE? WHY NOT?

4.2.1.1. The economic explanation

The reasoning for carrying out retaliation is rather clear: punishment to another country’s economy in order to make them comply with a World Trade Organization ruling. Thus, the key questions regarding retaliation and economical asymmetries are two: can the complaining country carry out the Dispute Settlement mechanism’s last resort, and also, is it sufficient to provoke a change in the respondent’s behavior as to induce compliance?

While analyzing case-studies and setting forth the notion of trade-distortion, it has already been documented that retaliation is harmful to both the complainant and the respondent’s economy, leading to what Anderson argues as an inherent injustice of the retaliatory measure (2002, p. 10). Therefore, the ability to carry out harmful economic policy as a way of punishment to another country is proportional to the extent of trade existing in the retaliating country\(^{86}\), the higher the amount of trade, the easier it is to carry out retaliation. It has already been established that in the Bananas case the United States and Ecuador followed opposite paths in pressuring the European Communities towards compliance as a result of the amount of trade they conduct. The evidence and information gathered suggest that the

\(^{86}\) Professor Kym Anderson, an arbitrator and panelist in the Bananas Case, readily points out (2002, p. 10) that “for small or developing countries confronting a much larger trader, that may well deter them from seeking recourse through the DSU or, should the Arbitrator rule in their favour, from adopting retaliatory measures.”
difficulties faced by Ecuador in carrying out retaliation in this dispute can be generalized to every similar situation.

The threat of retaliation in the part of Ecuador, carries with it only the slightest economic pressure, as it is hardly credible, which leads to the question: if the threat of economic sanctions carried out by Ecuador did not move the European Communities in the direction of compliance, then what did? Reputational damage seems to be the answer. Although Ecuador benefited mightily from entering a dispute in which the United States was on its side (Andersen\textsuperscript{87}), reputation appears to be the reason why the European Communities agreed to promote – even if short of full compliance – changes to its banana regime. The issue of reputation is also capable of clarifying the decision-making dynamics that led to almost 10 years of disagreements in regards to compliance in the case of bananas. In the previous case-study analysis, it became evident that noncompliance flourished in cases that were of considerable political and economical importance. That is directly linked to the limitations as to what reputational pressure and threats to this reputation can achieve. As Lebow and Schelling point out (1996;1960), when significant interests are at stake, threats, even if very severe, are bound to fail, which explains the foot-dragging strategy applied by the European Communities. Another aspect of retaliation in the Bananas dispute is the fact that the United States, a trade giant, not only threatened to retaliate but actually carried out retaliation against the European Communities, something it did again the Hormones case. In the bananas case, the strategy was of mixed success\textsuperscript{88}, whereas in the Hormones case the sanctions are still ongoing (as of January 2006). Consequently, the effectiveness of retaliation as an economic measure is severely criticized\textsuperscript{89}.

\textsuperscript{87} Interview given in Geneva on October 21, 2005.
\textsuperscript{88} Qualifying whether the United States was successful in inducing compliance through retaliatory measures depends strictly on how one might define success. If success is achieving full compliance, then no.
\textsuperscript{89} In a communication by Ecuador with purpose of improving the dispute settlement understanding of the WTO (WTO document: TN/DS/W/9), the Ecuadorians argue the inefficacy of retaliation, stating that “(...) the problem (...) is not that a developing country cannot take retaliatory measures but that they were not effective in
In pursuit of compliance: Lessons from the WTO’s Dispute Settlement Mechanism

In the cases involving Brazil and Canada in the issue of aircrafts, again, the ineffectiveness of retaliatory measures are exposed, as none of the countries retaliated and Rambod Behboodi, counsel for Canada, expressed his frustration at the inability to enforce a favorable ruling of the DSB\(^{90}\). In this dispute, the tit-for-strategy employed by the two countries led to a decline in noncompliant measures, thus the use of retaliation as a threat to each other was successful in inducing compliance, as the two countries refrained from hurting each other (more) economically. Not coincidentally, Brazil and Canada have economies of similar size\(^{91}\).

In the previous chapter, by the use of the *pendulum* metaphor, this research observed the notion that compliance in the WTO concerns economic issues, is scrutinized in a legalistic environment and influences and is influenced by political aspects. Economically, evidence has shown that retaliation is highly inappropriate as a way of achieving the purpose set out in the DSU. However, just as compliance, retaliation is not purely defined by its economic circumstances. It has already been indicated that retaliation and the threats that come with it affect reputation, which in turn affects the expectations actors might have in iterated games. As will be demonstrated in the next section, retaliation, too, has a political facet.

4.2.1.2. The politics of retaliation

If pursuing compliance is to a degree the pursuit of a political decision, then retaliation, one of its components, also has a political facet. The ineffectiveness of trade sanctions in achieving their economic purpose in the cited cases does not necessarily mean

\(^{90}\) See page 37.
\(^{91}\) Brazil has the fourteenth largest economy in the world, Canada the ninth (World Development Indicators database, World Bank 2004).
trade sanctions as a whole are ineffective. If the suspension of concessions is not effective at all, then the managerial proposition that sanctions are highly ineffective would prevail over the political economy perspective that prescribes the use of retaliatory measures. In order to examine this question, analysis on the political effects of the use of retaliation ensues.

Theories of strategy and the use of threats indicate that success in using reputational pressure finds its limits in direct proportion to the importance of the issue being disputed. If that is true – and at the present research, it is so assumed – then an essential element to achieving compliance through retaliation is the ability to conduct political bargaining with the “retaliation chip”. Dispute settlement decisions by the World Trade Organization, affect a country’s domestic constituency, who, in turn, pressure their own government for a particular stance regarding the international institutionalization of trade topics (Shaffer 2004, p. 10). The use of retaliation, in this perspective, can be very powerful in moving domestic constituencies’ opinions, in shaping a governmental decision and in preventing sanctions from being imposed, thus improving compliance (Andersen92; Goldstein & Martin 2000; Pannatier93).

The strategy of threat of retaliation as a way of shaping another government’s decision was accurately used by the European Communities against the United States in the Steel dispute94, when even before the authorization for retaliation was granted by the WTO DSB, the European Communities threatened politically sensitive areas in its upcoming “hit list”95, moving domestic constituencies against each other96 and managing to induce the US government into modifying its legislation. Similar pressure was exercised by the United States

---

92 Interview given in Geneva on October 21.
93 Interview given in Geneva on October 21.
94 Apart from the European Communities (WT/DS248), other seven countries (Japan WT/DS249, Korea WT/DS251, China WT/DS252, Switzerland WT/DS253, Norway WT/DS254, New Zealand WT/DS258 and Brazil WT/DS259) filed a similar complaint against the United States regarding safeguards measures applied by the United States in its steel industry. There seems to be no doubt that the European Communities led the dispute.
95 President Bush’s reelection campaign was in full force and the European Communities sanctions list included Florida’s juice and Pennsylvania’s steel among others – all battleground states for his reelection.
96 [http://www.foxnews.com/story/0,2933,104925,00.html](http://www.foxnews.com/story/0,2933,104925,00.html)
against the European Communities in the Hormones and Bananas retaliation list, which focused mostly on French and German goods, presumed to be the most stringent defendants of protectionist measures. If the aforesaid strategy proved to be of importance when involving the two largest trade actors in the world, could it work for other countries, and in what circumstances?

The existence of a strategy of political pressure of retaliation alone appears to legitimize the widely proposed view that the economic aspects of retaliation are mutually destructive. In order to downplay this destructive aspect and increase their political bargaining power, Ecuador, in the Bananas case, was authorized to retaliate on the sector of intellectual property, by breaking European Communities’ held patents. There is a concealed effect of legalization in this decision, since, the logic of iterated games aligned with the idea of jurisprudence leads to the idea that if Ecuador could cross-retaliate, then bigger countries could cross-retaliate as well, something not at all desired by the United States or the European Communities, which could strengthen the bargaining position of the complainant, diminish the effects of economic asymmetries and effectively point towards compliance. The importance of the political aspect of retaliation should not be underestimated as in the inappropriateness of the economic facet of retaliation, it plays an essential part in inducing compliance, even if at a sometimes very slow pace.

---

97 Interview with high ranking European Communities official in Geneva, on October 17, 2005.
98 Smith (2003, p. 3-4): “Ecuador's negotiators also made assertive use of certain WTO rules to enhance their bargaining leverage. (…)Ecuador's innovative request to cross retaliate focused on the intellectual property rights of European firms in several sensitive sectors, including industrial design patents, copyrights in the music industry, and (most significantly) geographical indications for alcoholic beverages. By obtaining this authority, Ecuador signaled its commitment to press for full compliance on the part of the EU, enhancing its leverage in subsequent negotiations.”
99 Brazil is threatening to do exactly that in the ongoing Cotton dispute against the United States. Basso and Beas (2005) argue that “For example, if Brazil threatened to suspend the transfer of royalty payments to Pfizer and other US pharmaceutical industries in retaliation to the country’s illegal cotton subsidies; Pfizer and the rest of the industry would end up lobbying the politicians in favour of the current cotton policy to reach a quick and effective solution to the problem.”
4.3. THE EFFECTS OF THE CURRENT RETALIATION PROCESS ON COMPLIANCE THEORY

4.3.1. No punishment, no problem?

Evidence has shown that as an economic punishment, retaliation is inappropriate, ineffective and mutually harming. On the other hand, the political facet of retaliation provides a bargaining chip that has shown to point towards to compliance, but at a great negotiation cost. What are the ramifications of this for both the managerial and political economy approaches to compliance?

Noncompliance derives from a decision of a panel convened under the premises of Article 21.5 of the Dispute Settlement Understanding, and is only after such stage that countries might ask for an arbitrator to calculate the amount of retaliation they are allowed to enforce. In the absence of retaliation, could it be that only the declaration of noncompliance from the Article 21.5 Panel could affect countries in a way to make them move towards compliance? If this is true, then the managerialists would rest correct in their view of the ineffectiveness of the use of sanctions. However, this appears not to be the case.

As of now, the evidence has suggested what leads countries to compliance in the WTO: legal characteristics of the Dispute Settlement mechanism that allow for predictability; a continued process, which minimizes defection; reputational damages in case of nonconformity; threat of retaliatory measures, which increases domestic pressure to induce modifications. Of the four elements leading to compliance, a managerialist might argue that only the threat of retaliation would be compromised if the WTO would do away with this enforcement tool. This preliminary assertion, nevertheless, would be inaccurate. Retaliation is the visible element that allows for the effects of the assertions above to take place. It is the moment where it is made clear that noncompliance has consequences, that the Dispute Settlement mechanism has teeth, even if it results in an imperfect bite.
Could it be enhanced? Certainly. The shortcomings of retaliation as an economic threat shows that the challenge at hand is to come up with a solution that is not harmful to the complainant and, as such, the problem regarding retaliation is not that it is a sanction – as the managerialists would argue – but that it is not the more adequate one, as will be further observed in the next chapter. The evidence here presented has shown that states have a propensity to comply, unless the disputes involve highly sensitive cases, in which case retaliation is key in inducing actors to change course, towards conformity. In this sense, a dichotomy arises, since retaliation is the enforcement key that allows some managerial effects to take place. At the same time, the effects of retaliation are not those of punishment, but those of management.

The limits as to the implementation of the WTO Dispute Settlement mechanism’s last resort – retaliation – reflects the limits of legalization of international dispute settlement, the limits of actors’ institutional choices as opposed to the exercise of their traditional notion of sovereignty. Increasing legalism does away with power politics to a degree, but it does not signify the end of it, with direct effects on compliance. If states comply unless the dispute represents a vital issue for them, then the larger the interest a state might have in a dispute, the more politically sophisticated a last resort measure must be, to promote and induce the political conditions necessary in order to prevent defection from a signed treaty.

Regarding the improvement of the DSM, various alternatives arise. An argument could be made for an even more legalistic approach, aiming at taking away the politics from the implementation phase. The question then becomes: would that be politically viable? Feasible? And if it is not, what’s next? Would an increase in enforcement tools through retroactive retaliation achieve the pursued success? Can collective retaliation be possible? These questions are addressed in chapter 5.
CHAPTER 5

H OW TO ENHANCE THE DISPUTE SETTLEMENT MECHANISM: PROPOSALS FOR REFORM
5.1. A NEED FOR REFORM

As Shaffer (2004) rightfully argues, assessment of the WTO – and in this case its Dispute Settlement mechanism – must be conducted from a comparative institutional analysis or the assessment results in no policy value at all\textsuperscript{100}. In light of that, the WTO Dispute Settlement mechanism success must not be judged against the fact that it does not allow for a supranational enforceable sentence to be carried out, but against the fact that, given this condition how well does it react? The same system that allows Ecuador to complain about European Communities tariff policies in a multilateral, neutral environment is sluggish when carrying out a decision in this very dispute. So the system is imperfect, but the alternative to it – absence of any Dispute Settlement mechanism - would result in a much grimmer reality for countries in the same position as Ecuador, hurt by unlawful trade policies. With that in consideration, it is unquestionable that the Dispute Settlement mechanism could benefit from changes, especially those concerning the issue of compliance. Immediate noncompliance is almost a natural consequence of bringing politically sensitive disputes into the system. Retaliation draws a great amount of criticism for being in the opposite way of trade liberalization. There is room for improvement. What should be done? How? A few considerations on the diagnosis conducted in the study should be pointed out.

Problems of noncompliance are of the political kind. As a result, solutions should come by addressing said circumstance. The Sutherland Report\textsuperscript{101} (2005, p. 54) explicitly acknowledged as much, arguing that \textit{\textquotedblleft effective compliance will not really depend so much in the specific remedies – including retaliation or compensation – contained in the

\textsuperscript{100}“All institutions are imperfect. (…) global governance mechanisms will be judged by critics from whatever political perspective against some ideal type of domestic governance process, or without reference to a counterfactual (…)”\textsuperscript{2} (Shaffer 2004, p. 2)

\textsuperscript{101}In celebration of its 10 year anniversary, the World Trade Organization’s Director-General commissioned a report by prominent scholars on the current status of the organization and the challenges presented for the future, which resulted in The Future of the WTO: Addressing Institutional Challenges in the New Millenium, commonly referred to as the Sutherland Report, because of its Chairman, former Director-General Peter Sutherland.
In pursuit of compliance: Lessons from the WTO’s Dispute Settlement Mechanism

DSU, but more on the general attitudes of WTO members, particularly the very powerful and large among them.” As a result, successful reform proposals should acknowledge this assessment, as the opposite would result in a dichotomous relation between diagnosis and remedy.

The previously conducted tests have pointed towards a range of characteristics that affect compliance in the World Trade Organization: the dual facet of a system that conducts its decisions in a legalistic environment and executes them in the realm of politics (1); the dual facet of its last resort enforcement tool, that fails its economic perspective and achieves considerable amount of success in regards to its political effects (2); the dual facet of a system that effectively pursues management through the threat of enforcement(3). How to cope with this scenario in order to pursue compliance is the object of analysis in the next section.

5.2. ASSESSING CURRENT REFORM PROPOSALS

In 1994 (p. 419), right before the establishment of the World Trade Organization, a Ministerial Decision established from the beginning a review of the proposed Dispute Settlement mechanism102. The Doha declaration of 2001, three years after the proposed deadline for a review maintained the need for continuing discussions, setting a deadline of May 2003. That deadline came and went without any modifications to the DSU. The recently finalized meeting in Hong Kong (2005) kept the idea that negotiations should continue but this time proposed no deadline103. Since its inception, there have been no

102 “(…) to complete a full review of dispute settlement rules and procedures under the World Trade Organization within four years after the entry into force of the Agreement Establishing the World Trade Organization, and to take a decision on the occasion of its first meeting after the completion of the review, whether to continue, modify or terminate such dispute settlement rules and procedures.”

103 “We take note of the progress made in the Dispute Settlement Understanding negotiations as reflected in the report by the Chairman of the Special Session of the Dispute Settlement Body to the Trade Negotiations
changes to the original Dispute Settlement Understanding and there has been no consensus about modifications to this international agreement. It is against this backdrop that the reform proposals are analyzed.

5.2.1. A far reaching reform: the proposal by Mexico

As seen before, negotiations on the DSU have been ongoing since the creation of the World Trade Organization, in 1995, with a number of ideas on how to improve it. When it comes to the issue of compliance, Mexico’s proposal to amend the Dispute Settlement Understanding is considered to be the most far-reaching (Andersen; Appleton; Pierola). As observed in Mexico’s proposal submitted to the WTO107 and reiterated by Diego-Fernandez and Huerta-Goldman108, Mexico’s view is that the biggest problems facing the Dispute Settlement mechanism in the WTO are in the period of time in which a party can keep its measure in nonconformity without consequence. As such, Mexico’s contribution focuses squarely on compliance and demands greater scrutiny from this research. Mexico’s proposal addressed three essential points (2002): (a) earlier application of retaliation; (b) retroactive retaliation and (c) possibility of negotiation of retaliation rights. Analysis is provided on the first two elements of the proposal together and then on the third element, separately.

The idea behind earlier application of retaliation is to cut the window of time during which a country can maintain a WTO-inconsistent measure without damages. Were the Mexican proposal approved, countries would be allowed to retaliate from the time of an

Committee (TNC) and direct the Special Session to continue to work towards a rapid conclusion of the negotiations.”

104 Interview given in Geneva on October 21, 2005.
105 Interview given in Geneva on October 22, 2005.
106 Interview given in Geneva on October 23, 2005.
107 WTO document: TN/DS/W/23
108 Interview given in Geneva on October 20, 2005.
Appellate Body favorable decision, significantly reducing procedural elements that can take almost two years. As for retroactive retaliation, such measure would result in increase of the amount of awarded retaliation, by allowing members to retaliate not only from the time of a favorable decision from WTO’s DSB, but from the time of implementation of the nonconforming measure in the violator’s country. These two moves would result in higher retaliation amounts being awarded, but would they pressure countries into higher rates of compliance? From what was presented so far, the problem with retaliation is that it is difficulty to carry out, not that it is a not large enough amount to pressure countries into compliance. Therefore, these two proposals by Mexico appear not to fit the diagnosis of the problems affecting retaliation as set out in this study. Increasing punishment would certainly fit the mold of an enforcement approach to compliance, but how would this punishment be carried out? The same questions that surround the issue of retaliation today would most likely continue to linger on should consensus be found about these two proposals.

The third aspect of Mexico’s proposal is the possibility of auctioning off retaliation rights – tradable remedies. This proposal is of great value, for it fits the diagnosis here presented, of difficulty that states have in carrying out retaliation, especially smaller trading countries. With such a measure, should a country be awarded retaliation rights, it can auction these same rights to a third country in exchange for other benefits. As reads the Mexican proposal, “facing a more realistic possibility of being the subject of suspended concessions, the infringing member will be more inclined to bring its measure into conformity” (2002, p. 6). Such modification could certainly bring more credibility to the threat of retaliation, since it is assumed that the country which “buys” the right to retaliate will be more than ready to fulfill the threat to retaliate until the end in case there is noncompliance.

The problem with such a measure however, is that, as one high-ranking official from the European Communities put it, “it is very difficult to determine from the outset, what
In pursuit of compliance: Lessons from the WTO’s Dispute Settlement Mechanism

the effects of such a move are”. As Bagwell, Mavroidis and Staiger (2003) – who support this idea - argue, what happens if no country is interested in buying these retaliation rights? It would be counter-productive and even decrease the bargaining position of the complainant. Questions like that make it very difficult for countries to move in acceptance of such a proposal. Four years from the first it was proposed, the notion of tradable remedies does not appear to have gained traction and considerable support from the WTO members.

5.2.2. The call for moderation: Do no harm

One of the problems when discussing reform proposals is that, when compared to the status of international law in other areas – where Hobbes still lives –, the WTO Dispute Settlement mechanism works considerably well. This fact, combined with the idea that the current rate of compliance is high, makes it difficult to make a hard push for change in dispute settlement. Scholars and practitioners have written extensively about the need to address the imperfections of retaliation and the effect that economic asymmetries have on compliance, however, these worries have yet not resulted in a consensus. The Sutherland Report summarizes this notion by proposing the idea that discussion on reforms should be guided by the principle of “do no harm”109.

Moderate proposal reforms address the question of sequencing110, provide greater clarification for interpretive matters and focus mostly on smaller procedural issues. Substantially speaking, these proposals provide only fine-tuning of what is already in place and note the limits of countries’ option for institutional choice. As a result, nothing advances.

109 “An important underlying concern, is, or should be, to not do any harm to the existing system, since it has so many valuable attributes.” (p. 56)
110 See Footnote 4.
To quote from Behboodi\(^{111}\), “there is no consensus on how to proceed with substantial changes, and no one is eager to modify the system to make minor procedural adjustments”.

5.3 Pursuing compliance through management or enforcement?

The characteristics of the WTO’s system for resolution of disputes constrain the possible compliance-enhancing measures that can be applied to it. While there appears to be a large consensus prescribing a non-trade distorting measure such as compensation (Anderson 2002; Charnovitz 2001), such compensatory measure must be done in a Most Favored Nation – MFN basis\(^ {112}\), which would make the difficulty for implementing such a measure quite severe. Another problem with compensation is that the current DSU already allows for compensation (financial or through the lowering of tariffs) before the granting of retaliatory measures\(^ {113}\), which means that there would be a necessity to make compensation mandatory, and, since no country can be forced to take proactive action, there would be again a problem of the limitations of legalized dispute settlement mechanisms.

The uniqueness in providing for an enforcement tool in an international legalistic procedure for dispute resolution is also its weakness, but again, there is a necessity to balance this weakness with the counter-factual. By recognizing the limitations of enforcement in international law, the settlement system of the WTO prescribes a noncompliance punishment – retaliation – that is not self-enforced, nor is it imposed by the

---

\(^{111}\) Interview given in Geneva on October 17, 2005.

\(^{112}\) In order to apply compensation to one country, the respondent would have to extend the compensatory measure to every country.

\(^{113}\) Article 22.2 of the DSU stipulates that: “If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings within the reasonable period of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation. If no satisfactory compensation has been agreed within 20 days after the date of expiry of the reasonable period of time, any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements”.

78
WTO DSBo. This is of key importance and derives from a simple assumption: if the responsibility for carrying out decisions were solely of the violator’s part, then there would be neither control nor incentives – besides reputational ones – to respect and absorb an unfavorable decision. Because retaliation is carried out by the offended party, the latter can influence the outcome of a compliance decision from the violator’s part. In this sense, although not desirable, retaliation is sorely needed, for it improves the chances of compliance while enhancing the bargaining position of the complainant.

Strengthening the ability of the plaintiffs to influence the outcome of a political decision to comply or not is essential to fulfilling the compliance objective. Can retaliation be modified as to produce more credible threats, in order to move domestic constituencies, build pressure and tilt the government’s hand towards compliance? The answer is a positive one. Without much modification from the Dispute Settlement Understanding, countries could be allowed to engage in carousel retaliation, playing different industry sectors against each other in order to induce compliance in the violator’s domestic legislation. Cross-retaliation should also continue to be allowed, not only as an exception, but as a rule. The violating party of a WTO agreement is a country, not an industry sector, and if the complainant country has a whole menu of industries to choose from when carrying suspension of concessions, again, the credibility of the threat would be magnified. Collective retaliation, in which all countries would be granted rights to retaliate law disobedience, while certainly a powerful enforcement tool, appears to indicate disproportional punishment to misdeeds and as a high-ranking official from the WTO put it, “there is absolutely no chance that this is ever going to get approved. I would be surprised if it is even discussed.” Punitive retaliation would increase the punishment taken by the violator in regards to retaliatory measures, but would it be a medicine directly related to the diagnosis here conducted? The answer is no. Increasing the

114 Interview given in Geneva on October 14, 2005.
115 In the same way, Hudec (2000) argues the same point, observing that “(…) the collective retaliation proposal has been abandoned as hopeless (…)”.

79
cost of punishment does nothing for improving the implementation of WTO DSB decisions. It would only expand the difficulties countries face when applying a retaliatory measure, especially if economic asymmetries are present. In the logic prescribed by Schelling (1960), if the threat is too costly for the threatening part, then its credibility is greatly tarnished. If retaliation today is seen as “shooting yourself in the foot” (Bronckers & Broake 2005), punitive retaliation would correspond to larger firepower against oneself.

As former Chairman of the World Trade Organization Dispute Settlement Body Celso Lafer put it\textsuperscript{116}, the system was not created overnight. It was a result of careful deliberations and all of the questions that are now being asked were considered then. As a result, expectations should be that any reform must come from within, enhancing the enforcement tools available today. The purpose must be not to increase the cost of punishment as indicated by the enforcement approach to compliance nor must it be to do away with the possibility of imposing sanctions, as would be proposed by managerialists. The key is enhancing the capability for carrying more credible and powerful threats in order to move the domestic constituencies of the respondent and increase the bargaining position of the complainant. Consequently, the dual facet of a system that effectively pursues management through the threat of enforcement should remain.

\textsuperscript{116} Interview given in São Paulo on June 18, 2005.
CHAPTER 6

CONCLUSIONS
6.1. RESEARCH FINDINGS

The research at hand set out to investigate the question of compliance and how it relates to theoretical approaches to the topic. Taking the World Trade Organization as a unit of analysis, managerial and enforcement approaches to compliance were tested and analyzed. It is then time to present the findings of this research.

First, the managerial assertion that states have a propensity to comply was evidenced by the statistical figures here presented, although it was noted that these numbers might be contaminated by factors that are empirically difficult to prove. When considering the “enforcement vs. managerial” debate however, the noncompliant cases exposed the managerial claim of compliance propensity to be tainted by endogeneity problems, as observed by enforcement proponents.

The significant effects that a legalistic procedure has on compliance is visible when considering that Dispute Settlement in the WTO follows the logic of an iterated game, allowing for the effects of jurisprudence and predictability to take place. Evidence showed that the WTO Dispute Settlement mechanism conducts its deliberations in a legalized environment and implements its decision in an environment that is highly political. When it comes to noncompliance, it was demonstrated through the use of interviews with relevant officials and analysis of several cases, that noncompliance is a political decision, rather than an inadvertent occurrence as managerialists would argue. As a result, the enforcement approach to compliance appears correct when noting that noncompliance is a result of a careful calculation of interests, even if those are somehow constrained by the institutional framework in which this compliance discussion takes place.

The managerial claim that enforcement is ineffective is challenged by evidence that retaliation carries political effects that can induce compliance with a reasonable amount
of success. However, the proposed observation by enforcement theory that higher rates of punishment have beneficial effects on compliance is also challenged by the inability of countries in carrying out tougher sanctions, most notably when economic asymmetries are present. As a result, the evidence suggests the existence of a dual facet of the enforcement logic in the WTO, namely, the management of compliance through the threat of sanctions.

Threats have shown limited capacity in affecting compliance. The difficulty of imposing a credible threat results from the inappropriateness of retaliation as an economic punishment, for it harms the retaliating country’s own consumers, something that is aggravated when economic asymmetries are present. As a result of its economical inappropriateness, threats have to rely on reputational and political pressure, influencing domestic constituencies as a way of conducting the violator towards compliance.

Reform proposals being considered at this point have sometimes shown a disconnection between the diagnosis presented and the proposal tabled. Proposals aiming to increase the cost of punishment have been seen as inappropriate as they would magnify current problems of the Dispute Settlement mechanism. The research has indicated that successful reform proposals should aim at increasing the credibility of threat as to follow the diagnosis verified by the tests conducted. In this sense, a complementary approach to compliance that is not merely reflective of the managerial or enforcement approaches is desirable.

6.2. RECOMMENDATIONS FOR FURTHER RESEARCH

The issues confronted in this work are far from being exhaustive analysis on the thematic of compliance and Dispute Settlement in the World Trade Organization. In light of that, several areas remain unexplored or not extensively explored terrain.
A constructivist theory of compliance has been conspicuously absent from the theoretical compliance debate. The role of norms and values within the specter of legalism and respect to international laws has so far been only peripherally explored by Chayes (1993). What a constructivist theory of compliance would look like and what it would say about the WTO’s Dispute Settlement mechanism is an interesting research topic that requires further study. Also, the complementary approach to compliance could benefit from greater scrutiny and more academic discussion. The work of Tallberg (2002) remains almost solitary in this respect.

The influence of power asymmetries in the issue of compliance also seems to have bypassed scholarly attention. How do power asymmetries affect compliance is a question that has received marginal attention from academia. The possible inter-dependence between compliance in different agreements and the effects derived from it could be further analyzed, as to investigate if there is reputational damage from noncompliance in different areas such as trade and security, for example.

“Outside the box” thinking is another area that could be further developed in research. Would it be possible to use retaliation rights to offset debts on another international organization (IMF?). Could it be used bilaterally to offset debts between economically asymmetrical countries? Changes like these require proper research in order to show their effects on compliance.
REFERENCES


