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David J. Townsend

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STRECHING THE DISPUTE SETTLEMENT UNDERSTANDING: *U.S.—COTTON’S RELAXED INTERPRETATION OF CROSS-RETALIATION IN THE WORLD TRADE ORGANIZATION*

*David J. Townsend**

I. INTRODUCTION

In August 2009, the World Trade Organization (“WTO”) authorized Brazil to impose sanctions against the United States for its continued subsidization of cotton producers¹ in violation of the WTO Agreement on Subsidies and Countervailing Measures (“SCM Agree-

* The author worked on the Senate Committee on Agriculture, Nutrition and Forestry from 2004–2006 for then ranking-Democratic Member, Senator Tom Harkin (D-IA). The author holds a master of science (MSc) from the London School of Economics in international political economy and a B.A. in political science and sociology from the University of Minnesota.

¹ Decision by the Arbitrator, *United States — Subsidies on Upland Cotton — Recourse to Arbitration by the United States Under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS267/ARB/1 (Aug. 31, 2009) [hereinafter *U.S. — Cotton* or *U.S. — Cotton* (4.11)]; see also Decision by the Arbitrator, *United States — Recourse to Arbitration by the United States Under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement*, WT/DS267/ARB/2 (Aug. 31, 2009). These reports are collectively referred to as *U.S.—Cotton* in this paper. Section V of both reports, on cross-retaliation, are identical, including paragraph numbering. The reports differ in that WT/D267/ARB/1 concerns retaliation for U.S. export credit guarantees and Step-2 payments (prohibited subsidies under the SCM) and WT/D267/ARB/2 concerns retaliation for U.S. Marketing Loan (ML) and Countercyclical payments (CC) (actionable subsidies under the SCM). See *U.S. — Cotton*, *supra*, ¶¶ 1.27-31 (discussing why the WTO issued two separate reports). I refer in the main body and footnote text to the *U.S.—Cotton* case to denote the entire U.S. — Brazil dispute over cotton subsidies. In citations, any reference to *U.S.—Cotton* is limited to the arbitrator’s decision in August 2009, as cited in this footnote. Where cited as *U.S. — Cotton* (4.11), this refers only to the report on prohibited subsidies. The Arbitrator held in these cases that Brazil could only cross-retaliate under non-GATT agreements if Brazil’s damages exceed \$409.7 million on an annual basis, and also found that the annual damages accruing to Brazil in this case were only \$294.7 million, *U.S. — Cotton*, ¶¶ 5.183, 5.201, 6.1-6.5. Following the report, however, Brazil has sought to demonstrate its current damages exceed the arbitrator’s calculations and would therefore allow cross-retaliation, see Erik Wasson, *USTR Under Pressure to Bring Cotton Compliance Panel After Ruling*, 27 *INSIDE U.S. TRADE* No. 34, Sept. 4, 2009 (saying that Brazil and U.S. farm groups believe the current figure “will likely be much higher when newer data is used”).

ment”)² and the Agreement on Agriculture.³ The WTO approved Brazil’s use of sanctions outside the General Agreement on Tariffs and Trade (“GATT”),⁴ authorizing cross-retaliation against rights owed to the United States under the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPS”).⁵ This is the third case of cross-retaliation authorized by a WTO arbitrator⁶ under the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).⁷

This paper considers when the WTO should permit cross-retaliation, which allows members to impose sanctions against the violating state outside of the WTO agreement where the violation took place.⁸ This paper provides evidence suggesting that the threat of cross-retaliation would not have changed Congress’ or the executive’s reaction to the *U.S.—Cotton* case and that the WTO’s emphasis on inducing compliance through cross-retaliation is misplaced. This paper argues that cross-retaliation under the DSU is most plausibly read to be limited to situations where only small amounts of goods, services, or intellectual property are exported from the violating state. The *U.S. — Cotton* de-

² Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Legal Instruments — Results of the Uruguay Round, 1867 U.N.T.S. 14 (1994) [hereinafter SCM Agreement], available at http://www.wto.org/english/docs_e/legal_e/24-scm.pdf.

³ Agreement on Agriculture, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Legal Instruments — Results of the Uruguay Round, 1867 U.N.T.S. 410 (1994), available at http://www.wto.org/english/docs_e/legal_e/14-ag.pdf.

⁴ General Agreement on Tariffs and Trade, Oct. 30, 1847, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT]; see *U.S. — Cotton*, *supra* note 1.

⁵ Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, Legal Instruments — Results of the Uruguay Round, 33 I.L.M. 1197 (1994) [hereinafter TRIPS]; see *U.S. — Cotton*, *supra* note 1.

⁶ The other two cases are: Decision by the Arbitrator, *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services — Recourse to Arbitration by the United States under Article 22.6 of the DSU*, WT/DS285/ARB (Dec. 21, 2007) [hereinafter *U.S. — Gambling*]; and Decision by the Arbitrators, *European Communities — Regime for the Importation, Sale and Distribution of Bananas — Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU*, WT/DS27/ARB/ECU (Mar. 24, 2000) [hereinafter *E.C. — Bananas*].

⁷ Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Legal Instruments — Results of the Uruguay Round, 33 I.L.M. 1226 (1994) [hereinafter DSU].

⁸ *Id.* art. 22.3.

cision allowing cross-retaliation where Brazil imports significant amounts of American goods therefore stretches the DSU to a legally distorted position. In short, this paper argues that: (1) legally, the DSU is better understood to preclude cross-retaliation on the facts of the *U.S. — Cotton* case; and (2) politically, cross-retaliation is unlikely to induce greater compliance with WTO obligations in many cases. Overall, this paper advocates a greater reliance on the level of trade between the countries in determining whether cross-retaliation is appropriate.

This paper proceeds as follows: Part II provides an overview of the DSU and the legal standard for cross-retaliation established under DSU Article 22.3. Part III examines the most recent ruling concerning cross-retaliation under DSU Article 22.3 and demonstrates that the *U.S. — Cotton* case relaxes the cross-retaliation legal standard. It argues that WTO arbitrators should focus more on the level of trade between the members in the dispute. Part IV examines the American response to the *U.S. — Cotton* case and shows that the threat of cross-retaliation was unlikely to induce the United States to change certain farm programs in order to comply with WTO rulings. Part V concludes with cautionary remarks concerning the use of retaliation under the WTO more broadly.

II. CROSS-RETALIATION UNDER DSU ARTICLE 22.3

A. *DSU Article 22.3 in its Context and in Light of the DSU's Object and Purpose*

The DSU both constrains and enables states to retaliate under the WTO. The DSU authorizes cross-retaliation aimed at inducing compliance from the violating state. At the same time, the DSU constrains retaliatory actions by limiting the size of retaliation and establishing procedures that must be followed before cross-retaliation is permissible. This section argues that retaliation under the DSU article should be read as having broader goals than simply inducing compliance.

When a WTO member violates trade obligations and fails to comply with rulings that find its domestic measures to be illegal under the WTO, DSU Articles 22 and 3 require victim states to pursue a hierarchy of remedies against a violating state before retaliating.⁹ The hierarchy starts with requiring an effort by members to reach a “mutually acceptable” solution, which is “clearly . . . preferred.”¹⁰ Next in the hierarchy is for the violating state to compensate the victim

⁹ *Id.* arts. 3, 22.

¹⁰ *Id.* art. 3.7. DSU Article 22.2 requires members to first enter into negotiations to find a mutually acceptable solution until a reasonable period of time has ex-

state.¹¹ Compensation must be accorded on a most-favored-nation basis and thus is rarely used.¹² As a “last resort,” Article 3 allows states to “suspend [] . . . concessions”¹³ (the WTO’s term of art for retaliation)¹⁴ that would otherwise be owed to the violating state under WTO agreements.

Retaliation under the WTO requires following the procedures established in DSU Article 22.3.¹⁵ A state must suspend concessions within the same sector or agreement,¹⁶ unless doing so “is not *practicable or effective*.”¹⁷ If not practicable or effective, and the victim state considers “circumstances are serious enough,” it may cross-retaliate by seeking to suspend trade concessions in other WTO agreements.¹⁸ DSU Article 22.3(d) provides factors to consider in suspending concessions across agreements; including trade under the agreement, the importance of that trade to the complaining party, and “the broader economic elements related to the nullification or impairment and the

pired, plus 20 days, for the violating state to bring its law into compliance with WTO obligations, *see id.* art. 22.2.

¹¹ *See id.* arts. 3.7, 22.2.

¹² KEVIN KENNEDY, INTERNATIONAL TRADE REGULATION: READINGS, CASES, NOTES AND PROBLEMS 43 (2009) (arguing that the MFN requirement for compensation has “effectively gutted compensation as a remedy”). A recent example of such compensation is new concessions given to the EU following the *U.S. — Gambling* decision, *see Public Citizen Warns of Error in U.S.-EU Gambling Compensation Deal*, 27 INSIDE U.S. TRADE, No. 26 (July 3, 2009) (discussing legal problems with the compensation and its relation to the *U.S. — Gambling* case).

¹³ DSU, *supra* note 7, art. 3.7.

¹⁴ World Trade Organization, Hong Kong WTO Ministerial 2005: Briefing Notes, http://www.wto.org/english/thewto_e/minist_e/min05_e/brief_e/brief10_e.htm (stating that to “suspend concessions” under the DSU is also known as “to retaliate”); *see* Steve Charnovitz, *Rethinking WTO Trade Sanctions*, 95 AM. J. INT’L L. 792, 805–08 (2001) (discussing how the term “sanctions” came to be used in WTO commentary instead of “suspension of concessions”).

¹⁵ *See* DSU, *supra* note 7, art. 1 (explaining the scope of the DSU).

¹⁶ DSU Article 22.3(a)-(b) requires retaliation within the same “*sector(s)*” or the “*same agreement*” unless it is impracticable or ineffective, DSU, *supra* note 7, art. 22.3(a)-(b). Sector is defined under DSU Article 22.3(f). For goods, sector means *all goods*, *id.* art. 22.3(f)(i). For the cases considered here, the distinction between sector and agreement is irrelevant. I refer in this paper to cross-retaliation under the same “agreement,” but it is important to note that in some circumstances, states must first show ineffectiveness and impracticability within the same sector before considering whether they can retaliate more broadly within the same agreement.

¹⁷ *Id.* art. 22.3(b)-(c) (emphasis added).

¹⁸ *Id.* art. 22.3(c). WTO arbitrators have deferred to the complaining state’s assessment that the circumstances were serious enough to cross-retaliate. *See U.S. — Cotton*, *supra* note 1, ¶ 5.217; *U.S. — Gambling*, *supra* note 6, ¶ 4.113; *E.C. — Bananas*, *supra* note 6, ¶¶ 126–27.

broader economic consequences of the suspension of concessions or other obligations.”¹⁹ Compliance with these procedures is subject to review by WTO arbitrators.²⁰ The text of DSU Article 22.3 therefore establishes the practicable and effective standard and the context of DSU Article 22.3 establishes the hierarchy of remedies. WTO arbitrators have looked to the broader purpose of retaliation under the DSU to give the practicable and effective standard greater clarity.²¹

WTO agreements are interpreted according to customary international law,²² including analyzing treaty text in its context and in light of the treaty’s object and purpose.²³ Much of the DSU supports the proposition that its purpose is to induce violating states to remove offending measures.²⁴ The DSU provides that the “first objective” when a member is in violation of obligations is “to secure the withdrawal of the measures concerned.”²⁵ The DSU also provides that sanctions are “temporary measures,”²⁶ used as a “last resort”²⁷ when a member obstinately refuses to comply with its WTO obligations. The overarching purpose of the DSU is ensuring predictable results within

¹⁹ DSU, *supra* note 7, art. 22.3(d)(i)-(ii).

²⁰ *Id.* art. 22.3; see *U.S. — Cotton*, *supra* note 1, ¶¶ 5.50–51; *U.S. — Gambling*, *supra* note 6, ¶ 2.16; *E.C. — Bananas*, *supra* note 6, ¶¶ 50, 51. The DSU might be read to preclude a probing analysis by WTO arbitrators of a complaining member’s choice of retaliation in light of its references to, for example, whether a party “considers that it is not practicable or effective” to impose sanctions within the same sector or agreement, DSU, *supra* note 7, art. 22.3(a)-(b) (emphasis added). Additionally, the arbitrators review “shall not examine the nature of the concessions or other obligations to be suspended but shall determine whether the level of such suspension is equivalent to the level of nullification or impairment,” DSU *supra* note 7, art. 22.7 (emphasis added). This suggests that these terms may have been intended to be self-defining by the complaining member. WTO arbitrators have found authority to review adherence to the DSU procedures in Article 22.3 by citing their obligation under DSU Articles 22.6 and 22.7 to evaluate compliance with the DSU procedures, *U.S. — Cotton*, *supra* note 1, ¶¶ 5.50–51; *U.S. — Gambling*, *supra* note 6, ¶ 2.16.; *E.C. — Bananas*, *supra* note 6, ¶¶ 50–51.

²¹ See *U.S. — Cotton*, *supra* note 1, ¶¶ 5.81; *U.S. — Gambling*, *supra* note 6, ¶ 4.29; *E.C. — Bananas*, *supra* note 6, ¶¶ 72, 76.

²² See DSU, *supra* note 7, art. 3.2 (specifying that a purpose of the DSU is to “preserve the rights and obligations of Members. . . in accordance with customary rules of interpretation of public international law.”).

²³ Vienna Convention on the Law of Treaties, art. 31, *opened for signature* May 23, 1969, 1155 U.N.T.S. 331 [hereinafter Vienna Convention].

²⁴ See DSU, *supra* note 7, art. 3.7.

²⁵ *Id.*

²⁶ *Id.* art. 22.1.

²⁷ *Id.* art. 3.7.

the multilateral trading system and to “preserve the rights and obligations of Members.”²⁸

WTO arbitrators considering the question have concluded that the object and purpose of the cross-retaliation is indeed to induce compliance from the violating member.²⁹ In the WTO arbitrators’ views, inducing compliance imbues the meaning of DSU Article 22.3 procedures, including what it means to be practicable or effective to suspend obligations within the affected agreement rather than employing cross-retaliation.³⁰ This view is supported by experts in WTO law.³¹

Given the textual support of such a reading, it seems clear that the DSU aims to induce the violating state to remove the offending measure. It is, however, not the *exclusive* purpose of the DSU. The DSU also constrains state responses toward the violating state, principally by limiting the level of retaliation “equivalent to the level of the nullification.”³² If inducing compliance from the violating state were the only goal, the DSU would approve retaliating as much as necessary to achieve this outcome.³³ Therefore, an equally plausible read-

²⁸ *Id.* art. 3.2.

²⁹ *U.S. — Cotton*, *supra* note 1, ¶ 5.81; *U.S. — Gambling*, *supra* note 6, ¶ 2.7 (noting that while retaliation aims at inducing compliance, it is limited by level of retaliation); *see E.C. — Bananas*, *supra* note 6, ¶¶ 72, 76.

³⁰ *See E.C. — Bananas*, *supra* note 6, ¶¶ 70–79; *U.S. — Gambling*, *supra* note 6, ¶¶ 4.29–31.

³¹ *See* John H. Jackson & Carlos M. Vázquez, *Some Reflections on Compliance with WTO Dispute Settlement Decisions*, 33 *LAW & POL’Y INT’L BUS.* 555, 562–66 (2002) (discussing various purposes of the DSU, including inducing compliance with underlying trade obligations); *see also* Charnovitz, *supra* note 14, at 804 (“[t]he tenor of these provision [the DSU] is that a suspension operates to drive compliance”). *But see* Warren F. Schwartz & Alan O. Sykes, *The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization*, 31 *J. LEGAL STUD.* §179, 189 (2002) (arguing that the WTO members are not obliged to comply with rulings, but may compensate the victim under the DSU if the violating state is “willing to pay that price”).

³² DSU, *supra* note 7, art. 22.4. The size of retaliation against subsidies is defined slightly differently. Under the SCM, members may impose “appropriate countermeasures” in response to prohibited subsidies. SCM Agreement, *supra* note 2, art. 4.10. In response to actionable subsidies, Members may impose retaliation “commensurate with the degree and nature of the adverse effects determined to exist.” SCM Agreement, *supra* note 2, art. 7.9. The Arbitrator in *US—Cotton* emphasized that SCM Article 4.10 gives greater “flexibility” in determining the size of countermeasures, although all three take into consideration the trade effects from the illegal measure. *See U.S.—Cotton* (4.11), *supra* note 1, ¶¶ 4.95–107.

³³ Thomas Sebastian, *World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness*, 48 *HARV. INT’L L.J.* 337, 365–66 (2007) (inducing compliance as the purpose of the DSU “is difficult to reconcile with the limitations on the intensity and form of retaliation set out in Article 22”).

ing of DSU Article 22.3 is that it seeks to limit and define the scope and substance of retaliation.

The DSU performs a “non-escalation” function, preventing rapidly escalating trade wars.³⁴ It does so by precluding retaliation by non-parties to a case.³⁵ Such retaliation undermines the compliance objective because the injury for violating WTO obligations runs to many WTO members.³⁶

The DSU also strives to provide “security and predictability” to disputes and to “clarify the existing” obligations of members under the WTO.³⁷ This suggests that the DSU clarifies the precise contours of legal obligations³⁸ and could be undermined by liberal use of retaliation against members for breaches of WTO obligations.

Finally, the DSU procedures might also be read as a political “safety valve,”³⁹ allowing breach of obligations under the WTO with certainty as to the cost of such breaches.⁴⁰ The United States argued in the *U.S. — Cotton* case that the DSU’s purpose was rebalancing the bargain under the WTO agreements by compensating victim states at a level equal to the injury caused by the violating state.⁴¹ This concept

³⁴ *Id.* at 378–80; *see also* Jackson & Vázquez, *supra* note 31, at 562 (arguing that parts of the DSU suggest “that its purpose may be simply to afford a peaceful mechanism for settling individual disputes.”).

³⁵ *See* DSU, *supra* note 7, art. 23.1 (“[w]hen Members seek the redress of a violation of obligations. . . they shall have recourse to, and abide by, the rules and procedures of this Understanding.”).

³⁶ *See id.* (“[w]hen Members seek the redress of a violation of obligations. . . they shall have recourse to, and abide by, the rules and procedures of this Understanding.”) (emphasis added); *id.* art. 22.3 (making the DSU the exclusive way to seek retaliation under the WTO).

³⁷ *Id.* art. 3.2.

³⁸ *See* Jackson & Vázquez, *supra* note 31, at 563.

³⁹ Charnovitz, *supra* note 14, at 818.

⁴⁰ *See id.* at 820 (seeing the DSU as a political safeguard puts it in “a more charitable light” than reading it as a sanction aimed at inducing compliance).

⁴¹ *See* Written Submission of the United States, *United States — Subsidies on Upland Cotton: Arbitration Under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement, United States — Subsidies on Upland Cotton: Arbitration Under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement*, WT/DS267, at ¶¶ 339–41 (Dec. 9, 2008) [hereinafter U.S. Submission to the Arbitrator], available at http://www.ustr.gov/webfm_send/572 (“[t]ailoring countermeasures to what is most likely to promote compliance invites Members to act *disproportionately*”); *see also* Schwartz & Sykes, *supra* note 31, at §181 (arguing the DSU deters “inefficient breach” of WTO obligations by limiting retaliation).

is controversial and has been rejected by commentators⁴² and, implicitly, by WTO arbitrators' reliance on inducing compliance.⁴³

Retaliation under the DSU is most plausibly read as enabling state retaliation, but also as constraining such a response. This dual-purpose understanding of the DSU is supported by the historical and legal context within which the DSU was adopted.

B. Placing the DSU Within Historical and International Legal Perspective

It is useful to contextualize the DSU remedies by looking at traditional remedies under international law and the pre-WTO GATT, as well as by examining the negotiating history of the DSU.⁴⁴ The DSU lies between the baseline of international legal remedies, which allow significantly greater compensation for breach of treaties, and GATT remedies, which were effectively non-existent because violating states could prevent their approval. When considered in light of its negotiating history and the international law of remedies, the DSU should be understood equally as constraining state retaliation as enabling it. By institutionalizing retaliation, treaty-makers allowed retaliation, but only in limited circumstances.

Post-World War II treaty makers created the GATT and its later-aborted institutional companion, the International Trade Organization ("ITO"), as a means to avoid the beggar-thy-neighbor policies that plagued the interwar years of the 1930s.⁴⁵ In crafting a trade regime premised on reciprocity and non-discrimination, post-war plan-

⁴² See Jackson & Vázquez, *supra* note 31, at 563–65 (arguing that rebalancing function undermines predictability and “conflates the primary obligations imposed on the members by the covered agreements and the secondary obligations provided for in the DSU” by effectively redefining the primary obligations); Sebastian, *supra* note 33, at 371 (asserting that this reading of the WTO asks DSU arbitrators to “rewrite the WTO agreements between the two WTO Member states”); See *supra* text accompanying notes 29–31.

⁴³ See *supra* note 29.

⁴⁴ The materials considered in this section are an appropriate way to confirm the meaning of DSU Article 22.3. The Vienna Convention allows considering “preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when interpretation according to article 31: (a) leaves the meaning ambiguous or obscure. . . .” Vienna Convention, *supra* note 23, art. 32.

⁴⁵ See ROBERT E. HUDEC, *THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY*, 6 (2d ed. 1990) (in describing the historical lesson of the interwar years, “[g]overnments in their desperation had experimented with many new and generally worse forms of trade restrictions.”); cf. Meredith A. Crowley, *An Introduction to the WTO and GATT*, 17 J. ECON. PERSPECTIVES 42, at 44–47 (2003) (describing how the WTO helps states avoid a prisoners dilemma where, although individually

ners sought a legal mechanism to avoid disproportionate and unconstrained responses to a member's protectionist policies.⁴⁶ The pre-GATT legal regime was characterized by states having, and often exercising, unbridled discretion to raise barriers against one another.

The GATT, by contrast, effectively precluded trade retaliation as a multilateral remedy. Authorized retaliation under the GATT was almost non-existent because the violating state could veto any ruling adverse to it.⁴⁷ This resulted in only one case of actual retaliation under GATT.⁴⁸ The WTO's DSU eliminates these problems by automatically establishing panels.⁴⁹ The DSU allows appellate review of alleged violations and the adoption of rulings unless the Dispute Settlement Body ("DSB") unanimously rejects a panel or appellate report.⁵⁰ Similarly, arbitrator reports are "final" and adopted by the DSB unless unanimously rejected.⁵¹

The negotiating context of DSU also suggests states were equally concerned with both enabling and limiting the scope and kind of retaliation possible under the DSU. The United States sought to preclude WTO panels from authorizing compensation for *past* injury—a practice that GATT panels allowed in retaliation for GATT-inconsistent U.S. antidumping duties.⁵² Developing countries were concerned about the numerous new trade obligations contained in the WTO, including under GATS and TRIPS.⁵³ Countries were also concerned about the increasing use of unilateral sanctions, particularly U.S. sanctions under Section 301 of the Trade Act of 1974.⁵⁴ To address

rational to impose tariffs, it is collectively more efficient to coordinate open trade policies).

⁴⁶ See HUDEC, *supra* note 45, at 7 (stating that to avoid repeats of the interwar period, obligations were required "in binding form" that would "be looked after by a more permanent institution."). JOHN H. JACKSON, *THE WORLD TRADING SYSTEM*, at 31 (1997) (MIT Press 1989) (describing the post-war consensus concerning the "importance of establishing postwar economic institutions that would prevent these mistakes from happening again.").

⁴⁷ Sebastian, *supra* note 33, at 345.

⁴⁸ See *Netherlands Measure of Suspension of Obligations to the United States* (Nov. 8, 1952), GATT B.I.S.D. (1st Supp.) at 32 (1953) (authorizing retaliations against U.S. wheat for GATT obligations breached by section 104 of the Defense Production Act).

⁴⁹ DSU, *supra* note 7, art. 6.

⁵⁰ *Id.* arts. 16–17.

⁵¹ *Id.* art. 22.7.

⁵² Petros C. Mavroidis, *Remedies in the WTO Legal System: Between a Rock and a Hard Place*, 11 EUR. J. INT'L L. 763, 789–90 (2000).

⁵³ See Sebastian, *supra* note 33, at 347–49.

⁵⁴ See Schwartz & Sykes, *supra* note 31, at §198–200, 201–02.

these concerns, the DSU limited retaliation to a level equivalent of the obligation suspended and barred compensation for past harm.⁵⁵

The context of the WTO negotiations suggests that DSU Article 22.3 itself was a compromise both to enable and inhibit cross-retaliation. The proponents of TRIPS in Uruguay Round negotiations introduced the concept of the right to cross-retaliate and argued it was necessary to ensure a remedy under the DSU where the violating country exported no intellectual property to the developed countries, and thus there was nothing to retaliate against.⁵⁶ Negotiators agreed to permit cross-retaliation but limited it through the DSU's procedures in Article 22.3.⁵⁷ Thus, while states may impose sanctions against a

⁵⁵ Compare DSU, *supra* note 7, art. 22.4 (providing for suspension "equivalent to the level of nullification or impairment"), with GATT, *supra* note 4, art. XXIII(2) (allowing for retaliation "appropriate in the circumstances"); see also Schwartz & Sykes, *supra* note 31, at § 204 (concluding the DSU resulted from "the danger of excessive unilateral sanctions that exists in the absence of centralized oversight regarding the magnitude of sanctions."); Sebastian, *supra* note 33, at 347–48. The United States argued in *U.S. — Cotton* that the DSU should not be interpreted as focused on compliance, see U.S. Submission to the Arbitrator, *supra* note 41, ¶ 341 (arguing that inducing compliance is beyond the legal mandate of DSU arbitrators). Compensation for past injury was rejected in *U.S. — Cotton*, *U.S. — Cotton*, *supra* note 1, ¶ 3.62 (holding that Brazil may not seek countermeasures in retaliation for laws found to violate WTO obligations but subsequently removed). Peter Mavroidis argues that this is not the correct conclusion concerning the scope of remedies under the DSU, Mavroidis, *supra* note 52, at 790.

⁵⁶ See JOHN CROOME, *RESHAPING THE WORLD TRADING SYSTEM: A HISTORY OF THE URUGUAY ROUND* 244, 112–14, 279–83 (2d ed. 1999) (summarizing cross-retaliation in the DSU negotiations as "implied" by the TRIPS agreement and agreed to by those who did not support it because it was an important "bargaining chip" in DSU negotiations); see also Andrew L. Stoler, *The WTO Dispute Settlement Process: Did the Negotiators Get What They Wanted?*, 3 *WORLD TRADE REV.* 99, 103–04 (2004) (noting that cross-retaliation was a "specific objective" of the United States). *But see* Sebastian, *supra* note 33, at 348 (saying that developing countries viewed cross-retaliation as a way to "limit the enforceability" of the new WTO obligations). The broader negotiating history of the DSU suggests other countries strongly objected to unilateral imposition of U.S. sanctions and that the right to cross-retaliate, presumably under TRIPS, would hurt developing countries because revoking rights in other agreements would most likely be under TRIPS, see generally CROOME, *supra*, at 112–14, 126–29. This suggests cross-retaliation was contemplated only in rare circumstances: where retaliation within the same agreement was impossible because the violating state exported nothing under the agreement, the victim state could cross-retaliate to ensure it had a remedy under the DSU.

⁵⁷ Stoler, *supra* note 56, at 105 (distinguishing between affirming cross-retaliation permitted under the DSU, which was a goal for developed countries, and the limits of cross-retaliation in DSU Article 22.3, which were a "victory" for developing countries); see CROOME, *supra* note 56, at 279–83.

violating state, the DSU carefully limits the size and scope of permissible sanctions.

The DSU also stands in contrast to traditional compensation for wrongs against states under the international law of state responsibility. Under international law, a state is under an obligation to cease the violating actions.⁵⁸ This is consistent with the DSU which aims “to secure the withdrawal of the measures concerned if these are found to be inconsistent”⁵⁹ with WTO obligations. Unlike the WTO, however, the international law of state responsibility calls for compensation for *past* damages caused by the violating state.⁶⁰ The U.N. International Law Commission points to the Permanent Court for International Justice’s decision in *Factory at Chorzow* as establishing the right to compensation for past wrongs in international law: “[t]he essential principle . . . is that reparation must, so far as possible, *wipe out all the consequences of the illegal act and* reestablish the situation which would, in all probability, have existed if the act had not been committed.”⁶¹ Unlike the international law requirement to compen-

⁵⁸ *Report of the International Law Commission to the General Assembly, Draft Articles on Responsibility of States for Internationally Wrongful Acts, With Commentaries*, 56 U.N. GAOR Supp. (No. 10) at 26, U.N. Doc A/56/10, reprinted in [2001] 2 Y.B. Int’l L. Comm’n 241, U.N. Doc. A/CN.4/SER.A/2001, art. 30, [hereinafter *ILC Draft Articles*], available at http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (“[t]he State responsible for the internationally wrongful act is under an obligation: (a) to cease that act, if it is continuing . . .”).

⁵⁹ DSU, *supra* note 7, art. 3.7.

⁶⁰ *ILC Draft Articles*, *supra* note 58, art. 31. Article 31, entitled “[r]eparation” says that states are responsible “to make full reparation for the injury caused by the internationally wrongful act,” *id.*; see RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 901 (1987) (“[u]nder international law, a state that has violated a legal obligation to another state is required to terminate the violation and, ordinarily, to make reparation, including in appropriate circumstances restitution or compensation for loss or injury.”). Comment *e* of the Restatement provides that interest on compensation “is generally payable from the date of the injury to the date of the payment,” RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 901 cmt. e (1987). Article 35 of the International Law Commission’s Draft Articles similarly states that when one state breaches its international obligations, the violating state’s duty to provide reparations includes an obligation to “re-establish the situation which existed before the wrongful act was committed,” *ILC Draft Articles*, *supra* note 58, art. 35.

⁶¹ *Factory at Chorzow*, The Merits, (F.R.G v. Pol.) 1928 P.C.I.J. (ser. A) No. 17, at 47 (Sept. 13) (emphasis added); see *ILC Draft Articles*, *supra* note 58, art. 31 cmt. 2 (citing *Factory at Chorzow*, The Merits, (F.R.G v. Pol.) 1928 P.C.I.J. (ser. A) No. 13, at 47 (Sept. 13)). The Arbitrator cited the ILC’s Draft Articles in *U.S. — Cotton* for the proposition that the sole purpose of countermeasures is to induce compliance. See *U.S. — Cotton* (4.11), *supra* note 1, ¶ 4.113. The Draft Articles approve of countermeasures designed to address continued violations (permissible

sate for the loss of a state's expectation interest, under the WTO, once the offending measure is removed, the matter is considered resolved and becomes non-actionable under the DSU.⁶²

WTO negotiators thus opted out of customary international legal remedies and changed the status quo from the limited remedies available under GATT. The DSU is best viewed in this context as a carefully balanced agreement to limit protectionist impulses in trade law, while allowing effective WTO remedies.

III. THE EVOLVING STANDARD FOR CROSS-RETALIATION UNDER WTO ARBITRATION

WTO arbitrators have now authorized cross-retaliation in three cases.⁶³ The arbitrators have developed a shared vocabulary concerning DSU Article 22.3 and it thus appears they agree on the legal standard for when states may cross-retaliate. This section argues, however, that when the facts of these cases are examined, the most recent interpretation of DSU Article 22.3 in *U.S. — Cotton* represents a significant relaxation of cross-retaliation, one that is too liberal in light of the size and diversity of Brazil's trade with the United States. A greater emphasis on the level of trade between the victim and violating state is consistent with the DSU text and broader purpose of the DSU to both enable and constrain retaliation under the WTO.

The DSU constrains retaliation in two broad ways: first by limiting compensation to the "equivalent" of the ongoing harm and second by restraining the use of cross-retaliation according to the procedures in DSU Article 22.3.⁶⁴ This section only discusses the latter.

When states seek cross-retaliation, the WTO arbitrator looks to "whether the complaining party in question has considered the necessary facts objectively" and also "whether, on the basis of these facts, it

under DSU Article 22.3) and the right to seek remedies for past harm (impermissible under DSU Article 22.8). Compare *ILC Draft Article*, *supra* 58, art. 31, with *id.*, art. 49.

⁶² DSU, *supra* note 7, art 22.8 ("[t]he suspension of concessions or other obligations. . . shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed . . ."); *U.S. — Cotton*, *supra* note 1, ¶ 3.62 (holding that Brazil may not retaliate for U.S. laws found to violate WTO obligations but subsequently removed, even where Brazil alleged similar measures were subsequently re-enacted).

⁶³ See generally *U.S. — Cotton*, *supra* note 1; *U.S. — Gambling*, *supra* note 6; *E.C. — Bananas*, *supra* note 6.

⁶⁴ See Sebastian, *supra* note 33, at 348–49 (describing the DSU limits on retaliation as primarily those precluding collective retaliation and limiting cross-retaliation). The cross-retaliation analysis is analyzed separately from determining the level of damages, see *U.S. — Cotton*, *supra* note 1, ¶¶ 5.24–26.

could plausibly arrive at the conclusion that it was not practicable or effective” to retaliate within the same agreement.⁶⁵ If retaliation within the same agreement is *either* ineffective or impractical, the WTO authorizes cross-retaliation.⁶⁶ This has led to a consensus in defining “practicable” as “feasible” with reference to the harm such measures may impose on the retaliating country⁶⁷ and “effective” as able to increase “the likelihood of compliance” after the retaliation is imposed.⁶⁸

DSU Article 22.3(d) clarifies the “practicability” and “effectiveness” analysis by requiring consideration of general economic factors.⁶⁹ Whether cross-retaliation is permissible under WTO decisions depends on (i) the size and diversity of trade with the violating state⁷⁰ and (ii) the size of the complaining state’s economy and disparity in economic power between it and the violating state.⁷¹ This paper argues arbitrators should place greater emphasis on these textual commands rather than the broader purpose of inducing compliance.

The three cross-retaliation cases represent a spectrum of instances relaxing the DSU Article 22.3 legal standard. The least controversial authorization of cross-retaliation is in *U.S. — Gambling*

⁶⁵ *U.S. — Cotton*, *supra* note 1, ¶ 5.51 (quoting *E.C. — Bananas*, *supra* note 6, ¶ 52).

⁶⁶ *U.S. — Cotton*, *supra* note 1, ¶ 5.70; *U.S. — Gambling*, *supra* note 6, ¶ 4.29–30; *E.C. — Bananas*, *supra* note 6, ¶ 74.

⁶⁷ *U.S. — Cotton*, *supra* note 1, ¶ 5.73; *U.S. — Gambling*, *supra* note 6, ¶ 4.29; *E.C. — Bananas*, *supra* note 6, ¶ 74.

⁶⁸ *U.S. — Cotton*, *supra* note 1, ¶ 5.81; *see U.S. — Gambling*, *supra* note 6, ¶¶ 4.29–30; *E.C. — Bananas*, *supra* note 6, ¶ 72.

⁶⁹ DSU, *supra* note 7, art. 22.3(d)(ii).

⁷⁰ This analysis is dictated by DSU Article 22.3(d)(i) and arbitrators have universally considered it, DSU, *supra* note 7, art. 22.3(d)(1); *see U.S. — Cotton*, *supra* note 1, ¶¶ 5.111–41 (detailing the size and diversity of the Brazilian economy and trade between Brazil and the United States); *U.S. — Gambling*, *supra* note 6, ¶¶ 4.93–100 (discussing size and nature of service trade between Antigua and the United States); *E.C. — Bananas*, *supra* note 6, ¶¶ 87–120 (discussing size and nature of trade in goods and services).

⁷¹ This analysis is mandated by the terms of DSU Article 22.3(d)(ii) which requires consideration of “the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations,” DSU, *supra* note 7, art. 22.3(d)(ii); *see U.S. — Cotton*, *supra* note 1, ¶ 5.139 (expressly holding that size disparity between the countries alone does not make suspension within the agreement ineffective or impracticable); *U.S. — Gambling*, *supra* note 6, ¶¶ 4.89–92 (recognizing this as a valid consideration, but noting it must be tied to practicability and effectiveness); *E.C. — Bananas*, *supra* note 6, ¶ 73 (stating that where a “great imbalance” exists, the arbitrator should primarily consider only practicability, or “least harmful” retaliations, in deciding whether cross-retaliation is permissible).

where the arbitrator authorized Antigua to cross-retaliate against the United States for obligations breached under GATS.⁷² The total trade in services between Antigua and the United States was \$102 million.⁷³ The arbitrator concluded that it would not be practicable or effective for Antigua to retaliate within GATS because Antigua's trade under GATS with the United States was confined to transportation, insurance and tourism—sectors where retaliation would “entail a negative impact for the Antiguan local economy.”⁷⁴ Antigua had few retaliatory options and the arbitrator accordingly authorized cross-retaliation.⁷⁵

Next, along the spectrum is *E.C. — Bananas*' less-relaxed reading of DSU Article 22.3. In *E.C. — Bananas*, Ecuador imported somewhere between \$60.8 and \$194 million in consumer goods and \$198 million in services from the E.C.⁷⁶ *E.C. — Bananas* held that it was practicable and effective for Ecuador to retaliate against at least some of the consumer goods under the GATT but was not practicable or effective to do so against services under the GATS,⁷⁷ and thus permitted cross-retaliation.⁷⁸ Under the GATT, the arbitrator emphasized that while the retaliation on consumer goods may impose costs, Ecuador failed to show there were no alternatives available to importing E.C. goods and, therefore, could retaliate against at least some of those goods.⁷⁹ Under the GATS, retaliation against non-wholesale services imported would undermine foreign investment and cross border ser-

⁷² *U.S. — Gambling*, *supra* note 6, ¶¶ 4.117–19. The arbitrator first held that there could be no retaliation within the same sector because Antigua had almost no trade with the U.S. within the service sector in question, *see id.* ¶¶ 4.55–60. The arbitrator then considered retaliation within all GATS sectors and held any GATS retaliation would be impracticable and ineffective as well, *id.* ¶ 4.99.

⁷³ *Id.* ¶ 4.82.

⁷⁴ *Id.* ¶ 4.98.

⁷⁵ *Id.*

⁷⁶ *E.C. — Bananas*, *supra* note 6, ¶¶ 97–98, 119.

⁷⁷ Ecuador sought to retaliate against E.C. “wholesale trade services” under GATS. *Id.* at ¶ 61. Because this service trade is in the same sector as the obligations violated by the E.C., the arbitrator did not make any findings about whether retaliation against such services were effective or practicable, but simply authorized such retaliation under DSU Article 22.3(a). *See id.* at 62–64.

⁷⁸ *Id.* ¶¶ 101, 120. The arbitrator held that “Ecuador’s nullification and impairment” was \$201.6 million per year, *id.* ¶ 170. The arbitrator did not say how much of the consumer goods Ecuador must retaliate against before resorting to cross retaliation, but because the damages exceeded the total number of goods, it had to decide the cross-retaliation issue under GATS to afford Ecuador a remedy equal to its damages, *id.* ¶ 173(d).

⁷⁹ *Id.* ¶ 100. The *U.S. — Cotton* arbitrator explicitly rejected *E.C. — Bananas* in this interpretation and rejected requiring the victim state to show alternative supplies were available to demonstrate it was the “least harmful” mode of retaliation, *U.S. — Cotton*, *supra* note 1, ¶ 5.78.

vices, hurting the fragile Ecuadorian economy.⁸⁰ The United States later pointed to *E.C. — Bananas* case as establishing “bookends” on the DSU Article 22.3 practicable and effective standard.⁸¹ Under this reading, the *E.C. — Bananas* and *U.S. — Gambling* cases stand for the proposition that cross-retaliation is rarely necessary; only where the retaliating country has very small amounts of trade under the agreement is it impracticable and ineffective to retaliate within the same agreement. *E.C. — Bananas* and *U.S. — Gambling* are consistent with one another in that they allowed cross-retaliation, but only where there was a very limited number of cross-border transactions within the agreement where the breach occurred.

U.S. — Cotton rejected this understanding and provided the most relaxed interpretation of DSU Article 22.3 of the three cases. The arbitrator found that Brazil imported at least \$1.27 billion in consumer goods from the United States.⁸² The arbitrator then held that of those consumer goods, only food, arms, medical products and “other” goods are practicable and effective to retaliate against under DSU Article 22.3.⁸³ The arbitrator in *U.S. — Cotton* held that twenty percent of those consumer goods were practicable and effective to retaliate against, totaling \$409.7 million of goods Brazil must retaliate against before cross-retaliating in other agreements.⁸⁴

The *U.S. — Cotton* case departs from the previous readings of DSU Article 22.3 in two ways: (1) the arbitrator in *U.S.—Cotton* calculated a precise level of goods that were practicable and effective for Brazil to retaliate against; and (2) the arbitrator in *U.S. — Cotton* found that it was impracticable or ineffective for Brazil, a large and diverse economy relative to Ecuador and Antigua, to retaliate solely within the GATT.⁸⁵ Concerning the first difference, this significantly limits Brazil’s ability to cross-retaliate because the damages must, at

⁸⁰ *E.C. — Bananas*, *supra* note 6, ¶¶ 108–20.

⁸¹ U.S. Submission to the Arbitrator, *supra* note 41, ¶ 333.

⁸² *U.S. — Cotton*, *supra* note 1, ¶ 5.144 (assuming this figure, Brazil’s estimate, is correct). Both the *U.S. — Cotton* and *E.C. — Bananas* cases eliminated trade in capital or industrial goods from those where it could be practicable and effective to retaliate against, *id.* ¶ 5.149; *E.C. — Bananas*, *supra* note 6, ¶ 91.

⁸³ *U.S. — Cotton*, *supra* note 1, ¶¶ 5.166–78.

⁸⁴ *Id.* ¶¶ 5.181–83, tbl. 4. This figure also rejects as practicable or effective retaliation against food, pharmaceuticals and arms where U.S. market share exceeded twenty percent of Brazil’s imports, *id.* ¶ 5.182.

⁸⁵ The arbitrator in *E.C. — Bananas* did not calculate how much of the trade under GATT was practicable and effective for the E.C. to retaliate against, *see E.C. — Bananas*, *supra* note 6, ¶ 173 (stating that the E.C. may retaliate under TRIPS if an undefined level of goods where it was both practicable and effective to retaliate was less than its level of damages, set at \$201.6 million).

some future date, exceed \$409.7 million.⁸⁶ The *E.C. — Bananas* arbitrator, in contrast, required some retaliation against consumer goods before resorting to cross-retaliation, although it was unclear how much relation was necessary.⁸⁷ Nonetheless, the second finding significantly relaxed DSU Article 22.3 relative to previous decisions because cross-retaliation had not been approved where large volumes of commerce occurred from the violating state under the agreement breached.⁸⁸

A comparison⁸⁹ between the cases is straightforward because the violating members in all three cases are the United States and the E.C., which are among the largest trade economies in the world.⁹⁰ However, the economic factors relevant to the DSU Article 22.3 analysis show that the victim states differed in important ways. For example: Brazil's economy is almost thirty-two times larger than Ecuador's economy.⁹¹ Brazil's imports of American consumer goods were be-

⁸⁶ *U.S. — Cotton*, *supra* note 1, ¶ 5.183.

⁸⁷ *Compare id.* (holding Brazil was required to retaliate against \$409.7 million of consumer goods under GATT prior to cross-retaliating) *with E.C. — Bananas*, *supra* note 6, ¶¶ 97–101, 173(d) (holding Ecuador could cross-retaliate “[t]o the extent. . . [retaliation under GATT] is insufficient” but never specifying the precise level of consumer goods that Ecuador must retaliate against before cross-retaliating).

⁸⁸ *Compare U.S. — Cotton*, *supra* note 1, at ¶ 5.144 (noting \$1.27 billion in U.S. exports of consumer goods to Brazil) *with E.C. — Bananas*, *supra* note 6, at ¶¶ 97–99 (noting somewhere between \$60.8 and 194 million in E.C. exports of consumer goods to Ecuador); *U.S. — Gambling*, *supra* note 6 at ¶ 4.82 (noting \$101.8 million in U.S. exports of services to Antigua). By volume of trade, the *U.S. — Cotton* decision seems to be a significant relaxation of the DSU Article 22.3 standard. The arbitrators' view that only *consumer goods* should be practicable and effective to retaliate against has been criticized as “mercantilist.” *See Mavroidis*, *supra* note 52, at 806.

⁸⁹ It is worth noting the SCM Agreement provides for “appropriate countermeasures,” for prohibited subsidies, *see* SCM Agreement, *supra* note 2, art. 4.10, and retaliation “commensurate with the degree and nature of the adverse effects” of actionable subsidies, *see* SCM Agreement, *supra* note 2, art. 7.9, while the DSU provides for only retaliation that is “equivalent to the level of the nullification or impairment,” DSU, *supra* note 7, art. 22.4. The arbitrator in *U.S. — Cotton* held that the two standards provide for different *levels* of countermeasures, while the cross-retaliation procedures in 22.3 remained applicable under the SCM Agreement, *U.S. — Cotton*, *supra* note 1, ¶¶ 5.24–27.

⁹⁰ *See* WORLD TRADE ORGANIZATION, INTERNATIONAL TRADE STATISTICS 2009, at 13 (2009), available at http://www.wto.org/english/res_e/statis_e/its2009_e/its2009_e.pdf (listing the United States as the largest importer and third largest exporter and the European Union as the largest exporter and second largest importer).

⁹¹ U.N. Conference on Trade and Development, *Developing Countries in International Trade 2007: Trade and Development Index*, at 76, 94, UNCTAD/DITC/TAB/2007/2 (Nov. 6, 2007), available at http://www.unctad.org/en/docs/ditctab20072_

tween six and twenty-one times larger than Ecuador's from the E.U.⁹² Brazil's share of global export in goods and services is 1.66% while Ecuador's is only .13%.⁹³ Further, the diversity of Brazil's trade compared to that of Ecuador reveals that Ecuador's economy is significantly less diverse and more vulnerable to trade shocks than Brazil's economy.⁹⁴ These basic economic figures show a relaxation of the DSU Article 22.3 standard.

U.S. — *Cotton* misreads DSU Article 22.3 by focusing on inducing compliance to the detriment of economic factors listed in the treaty text. In assessing whether cross-retaliation is practicable or effective, the DSU lists weighing the "broader economic consequences" to the victim state of requiring retaliation in lieu of cross-retaliation.⁹⁵ The treaty text also focuses on the "trade. . . and the importance of such trade" to the victim state as well as "the broader economic elements" implicated by the violation.⁹⁶ Brazil had sufficient retaliatory options given its \$18.7 billion in imports of U.S. goods, including \$1.27 billion in consumer goods imports,⁹⁷ that the arbitrator should have confined retaliation to GATT instead of allowing cross-retaliation. Brazil's economic diversity and trade with the United States are simply too great to allow retaliation outside of GATT.⁹⁸

Interpreting DSU 22.3 as creating what might be termed a level of trade standard⁹⁹ gives fuller meaning to the treaty text¹⁰⁰

en.pdf [hereinafter U.N. TDI]. See *generally id.* (listing GDPs in individual country profiles).

⁹² See *U.S.* — *Cotton*, *supra* note 1, ¶ 5.144; *E.C.* — *Banana*, *supra* note 6, ¶¶ 97–99.

⁹³ U.N. TDI, *supra* note 91, at 76, 94 (listing individual country profiles).

⁹⁴ *Id.* For example, Brazil's trade performance index, which takes into consideration the country's share of trade in merchandise and services, the market concentration of its merchandise exports and the ration of exports to its GDP, *id.* at 9, scores considerably higher (102) than Ecuador (66), *id.* at 76, 94. Also, one study's attempt to create a composite index to assess vulnerability of developing countries for purposes of special treatment under trade law concludes that Brazil, because of its economic size and diverse basket of goods and services traded, would not merit special consideration while both Ecuador and Antigua would, see *generally* Fen-May Liou & Cherng G. Ding, *Positioning the Non-Least-Developed Developing Countries Based on Vulnerability-Related Indicators*, 16 J. INT'L. DEV. 751, 751–67. The vulnerability assessment seems particularly relevant under DSU Article 22.3 because it should be strongly suggestive of the amount of goods where it is practicable to retaliate against.

⁹⁵ *Id.* art. 22.3(d)(ii).

⁹⁶ DSU, *supra* note 7, art. 22.3(d)(i)–(ii).

⁹⁷ *U.S.* — *Cotton*, *supra* note 1, ¶ 5.144.

⁹⁸ See *supra*, notes 91–94 and accompanying text.

⁹⁹ WTO arbitrators have weighed level of trade in these cases, see *e.g.* *E.C.* — *Bananas*, ¶ 125–26, although the disparity in the level of trade between the victim

while remaining true to the object and purpose of the DSU to *both* enable and constrain retaliation under the WTO.¹⁰¹ Economic data suggests that the *E.C. — Bananas* and *U.S. — Gambling* decisions were appropriate under such a standard, while *U.S. — Cotton* departs from this principle.¹⁰² At some point, the DSU Article 22.3 limit on cross-retaliation must take priority over the goal of inducing compliance in order to give the legal standard a meaningful effect and the *U.S. — Cotton* case should have represented this point.

The DSU text and its context, as well as the DSU's object and purpose and the historical setting against which the text of DSU Article 22.3 was created suggest that the *U.S. — Cotton* interpretation of cross-retaliation distorts the legal standard. The next section addresses whether cross-retaliation would have been likely to change the U.S. reaction to the case.

IV. THE LIMITED UTILITY OF CROSS-RETALIATION

This Part explores the U.S. response to the *U.S. — Cotton* case. As discussed below, the *U.S. — Cotton* case is particularly insightful because the domestic laws held illegal by the WTO, four different farm programs, varied in the amount of political pain required to comply with the rulings.¹⁰³ The United States ignored some parts of the ruling¹⁰⁴ while making substantive legal changes to conform to other parts of the ruling.¹⁰⁵ The U.S. response demonstrates a desire to comply with its WTO obligations, but only where it could do so without changing fundamental policy choices.¹⁰⁶ The U.S. response suggests that the prime considerations of policy makers had little to do with the threat of retaliation under the WTO.¹⁰⁷ In short, this section argues that the prospect of cross-retaliation likely would not have changed Congress' or the executive's reaction to the *U.S. — Cotton* case. Finally, this Part argues there are strong theoretical reasons to believe that retaliation, more generally, will often fail to induce compliance.¹⁰⁸

states in *U.S. — Cotton* and both *E.C. — Bananas* and *U.S. — Gambling* shows the *U.S. — Cotton* Arbitrator significantly moved away from looking at the level of trade. See *supra*, notes 87–92 and accompanying text.

¹⁰⁰ Cf. DSU, *supra* note 7, art 22.3 (a)–(d).

¹⁰¹ See *supra* Part II.

¹⁰² See *supra*, notes 87–92 and accompanying text discussing economic data from the cases.

¹⁰³ See *infra*, Part IV.A.

¹⁰⁴ See *infra*, notes 116–17 and accompanying text.

¹⁰⁵ See *infra*, notes 104–15 and accompanying text.

¹⁰⁶ See *infra*, Part IV.A.1 & 2.

¹⁰⁷ See *infra*, Part IV.A & B.

¹⁰⁸ See *infra*, Part IV.B.

A. *The American Response to the WTO Cotton Case*

The programs at issue in *U.S. — Cotton* ranged from those that could be changed by executive fiat (export credit guarantees), those requiring Congressional approval but only affecting cotton producers (step-2 payments) and two generally applicable programs whose change would require far-reaching effects on American farm policy (countercyclical (“CC”) and marketing loans (“ML”) payments). Unsurprisingly, the U.S. response varied accordingly.

The WTO’s ruling that various subsidies to U.S. cotton producers violated the SCM Agreement produced three distinct responses in the American polity. First, the Bush Administration changed export credit guarantees to make them more subject to market conditions.¹⁰⁹ By making the fees subject to market conditions, the Bush Administration believed the United States no longer conferred a benefit on U.S. producers and would therefore no longer constitute a “subsidy”¹¹⁰ within meaning of the SCM Agreement. The U.S. Trade Representative (“USTR”) later argued that the United States effectively withdrew the illegal subsidies because they are market-based and operated at no-net cost to the government.¹¹¹ While these changes were later approved by Congress¹¹² with slightly more extensive statutory changes to the export credit guarantees,¹¹³ the programs were initially changed through legal discretion already available to the Department

¹⁰⁹ See Press Release, U.S. Dep’t of Agric., USDA Announces Changes to Export Credit Guarantee Programs to Comply with WTO Findings (June 30, 2005); U.S. Submission to the Arbitrator, *supra* note 41, ¶ 31, n.30 (summarizing changes to the export credit guarantee programs). The U.S. Department of Agriculture announced they would no longer accept applications for long-term export subsidies (GSM-103) and the Supplier Credit Guarantee Program (SCGP), that they had changed the fee structure of shorter-term export credit guarantees (GSM-102) and would change eligibility requirements for the loans based on the financial risk posed by guarantees to various countries, USDA Press Release, *supra*.

¹¹⁰ See SCM Agreement, *supra* note 2, art. 1 (defining subsidy); *id.* at annex I(j) (providing an “illustrative list of export subsidies.” which includes export credits “at premium rates which are inadequate to cover the long-term operating costs and losses of the programs.”).

¹¹¹ See Written Submission of the United States, *United States — Subsidies on Upland Cotton: Recourse to Article 21.5 of the DSU by Brazil*, ¶¶ 75–128, WT/DS267/AB-2008-2 (Feb. 19, 2008), available at http://www.ustr.gov/webfm_send/594.

¹¹² Food, Conservation, and Energy Act of 2008, § 3101, Pub. L. No. 110–246, 122 Stat. 1651 [hereinafter 2008 Farm Bill] (describing codification of executive changes and also lifting caps on fees for the program).

¹¹³ See H.R. REP. NO. 110–256, at 222 (2007); see also 2008 Farm Bill, §3101 (requiring a risk-based assessment of export credit guarantees).

of Agriculture (“USDA”).¹¹⁴ The Bush Administration changed the export credit guarantees prior to the deadline set by the WTO for compliance.¹¹⁵

Second, Congress eliminated the Step-2 program.¹¹⁶ The Step-2 program provided payments to purchasers of cotton to make-up the difference between more-expensive U.S. cotton and the international price of cotton, thereby encouraging its use by domestic mills and international buyers.¹¹⁷ Congress eliminated Step-2 in the context of a series of budget cuts trimming spending on other programs, but Step-2 was the only USDA program eliminated in those cuts.¹¹⁸ The Agriculture Committees in Congress eliminated Step-2 as part of broader cuts to agriculture programs mandated by the less farm-friendly Budget Committees under Congressional budget rules.¹¹⁹ In this context, Step-2 was eliminated because it allowed the Bush Administration and Congress to assert their intent to comply with WTO rulings,¹²⁰ while helping the Agriculture Committees meet their targets for spending cuts.

¹¹⁴ See 7 USC § 5622(a)–(c) (2005) (amended 2008) (providing USDA discretion in structuring the export credit guarantees with certain limitations). The older version of 7 USC § 5622 (b) & (c) have been replaced by the farm bill provisions enacted in 2008. See H.R. REP. NO. 110–627, at 757–59 (2008) (Conf. Rep.) (discussing changes to the program).

¹¹⁵ See Sophie Walker & Charles Abbott, *U.S. Tweaks Credits for WTO, Key Cotton Aid Untouched*, REUTERS, July 1, 2005 (noting the changes were “announced less than two hours before the deadline to act”).

¹¹⁶ Deficit Reduction Act of 2005 § 1103, 7 U.S.C. § 7937 [hereinafter 2005 Budget Reconciliation]; see also *Congress Approves Legislation Repealing Cotton Subsidy Program*, FARM FUTURES, Feb. 2, 2006, <http://farmfutures.com/story.aspx?s=27649&c=17>.

¹¹⁷ RANDY SCHNEPF, CONGRESSIONAL RESEARCH SERVICES, BRAZIL’S WTO CASE AGAINST THE U.S. COTTON PROGRAM, at 8 (Mar. 17, 2009), available at <http://www.nationalaglawcenter.org/assets/crs/RL32571.pdf>.

¹¹⁸ See H.R. REP. NO. 109–362, at 187–94 (2005) (Conf. Rep.) (describing the cuts to USDA programs). See generally 2005 Budget Reconciliation, *supra* note 116.

¹¹⁹ See H.R. REP. NO. 109–362. This process is called budget reconciliation and allows budget committees to “instruct” authorizing committees to make changes to mandatory spending programs, see ROBERT KEITH, CONGRESSIONAL RESEARCH SERVICE, BUDGET RECONCILIATION LEGISLATION IN 2005, at 1–5, (Nov. 1, 2005), available at <http://fpc.state.gov/documents/organization/57222.pdf> (providing an overview of budget reconciliation and recent Congressional use of budget reconciliation).

¹²⁰ See H.R. REP. NO. 109–276, at 7 (2005) (citing the *U.S. — Cotton* case as the impetus for eliminating Step-2); S. REP. NO. 110–220, at 30 (2007) (“[a]spects of U.S. export credit programs were successfully challenged in the 2005 WTO Brazil cotton case, and thus must be modified to bring the United States into compliance with the panel’s rulings in this case”).

Third, Congress did nothing concerning the CC and ML payments found to cause “serious prejudice” to Brazil in violation of the SCM and Agriculture Agreements.¹²¹ Those programs were extended through the 2008 Farm Bill and the arbitrator in *U.S. — Cotton* noted that when viewed side-by-side, both the ML and CC programs were identical and contained only minor changes not relevant to their legality under the WTO.¹²² The 2008 Farm Bill actually expands CC payments by giving farmers a new contract option in addition to those found illegal under the SCM.¹²³

What explains these different outcomes in response to the WTO ruling?

1. Changes in Programs Were Driven by a Desire to Comply With the WTO Rulings

The changes to export credit guarantees and elimination of Step-2 are best seen as reflecting a desire by the United States to comply with its WTO obligations. One explanation is that the United States never sought to comply with the rulings but wanted give the appearance of compliance while avoiding substantive changes.¹²⁴ Some evidence suggests that U.S. policy makers had no intent to comply with the rulings. First, the export credit guarantees, as found later by the WTO, were *not* in fact substantively changed but continued to

¹²¹ SCHNEPF *supra* note 117, at 23–24. Congress reauthorized CC and ML payments as part of the 2008 Farm Bill, with minor changes, *see* 2008 Farm Bill, *supra* note 112, title I. It also authorized a new form of CC payments, *see* H.R. REP. NO. 110–627, at 676–77 (2008) (Conf. Rep.) (describing a new CC contract option for commodity producers).

¹²² *See U.S. — Cotton*, *supra* note 1, ¶¶ 3.21–29. The United States asserted, and the arbitrator rejected, the seemingly frivolous argument that because the 2002 farm bill had legally “expired” and been replaced by the 2008 farm bill, the measures no longer existed, U.S. Submission to the Arbitrator, *supra* note 41, at 77–79. Neither Congress nor USTR assert that changes to the ML and CC payments bring the United States into compliance with the ruling, *see* U.S. Submission to the Arbitrator, *supra* note 41, at 77–79 (explaining that the USTR defense was based on calculation of damages rather than program changes). *See also* Press Release, Senator Chambliss Statement on WTO Decision Against U.S. Cotton (Aug. 31, 2009) (defending the ML and CC payments as lawful because of declining global market share of U.S. cotton exports); *cf.* S. REP. NO. 110–220, at 90–91 (making a passing reference to Congressional changes to ML and CC payments in asserting U.S. compliance with the WTO rulings).

¹²³ *See* 2008 Farm Bill, *supra* note 112, § 1105; *see also*, DAN MORGAN, THE FARM BILL AND BEYOND 53 (German Marshall Fund of the United States, Jan. 2010) (quoting a source as saying the new program is a “time bomb” under WTO rules for the United States).

¹²⁴ *See* Mavroidis, *supra* note 52, at 794 (describing how the WTO DSU procedures allow for states to behave in bad faith following DSU rulings against them).

function as export subsidies.¹²⁵ Also, given the wide variety of domestic payment support for cotton producers, including ML and CC payments, elimination of the Step-2 program may seem insignificant.¹²⁶ Additionally, the United States enacted measures in the 2008 Farm Bill that appear similar to the WTO-illegal Step-2 program and give a four cent per pound subsidy to users of cotton.¹²⁷ Finally, key policy makers asserted that the United States would continue prohibited cotton subsidies regardless of WTO obligations to the contrary.¹²⁸

Asserting that the United States had no intent to comply, however, ignores that there has been *some* substantive change to U.S. farm policy that would not have taken place absent the WTO rulings. Congress' elimination of the Step-2 program removed an expected \$282 million in payments to purchasers of American cotton.¹²⁹ The changes to the export credit guarantees removed access to long-term guarantees on export financing and changed the users fees associated with those programs.¹³⁰ Both the Bush Administration and Congress were eager to demonstrate their commitment to making changes in light of the ruling. Bush Administrations officials consistently stated their intent to comply¹³¹ and, while Congress gave mixed signals, key Congressional committees have asserted U.S. compliance with the rulings based on these changes.¹³² Further, the timing and selection of

¹²⁵ See Appellate Body Report, *United States — Subsidies on Upland Cotton Recourse to Article 21.5 of the DSU by Brazil*, WT/DS267/AB/RW (June 2, 2008).

¹²⁶ See Michael J. Shumaker, Comment, *Tearing the Fabric of the World Trade Organization: United States - Subsidies on Upland Cotton*, 32 N.C. J. INT'L L. & COM. REG. 547, 552–60 (2007) (summarizing USDA's cotton subsidies).

¹²⁷ See 2008 Farm Bill, *supra* note 112, § 1207(c) (establishing a new subsidy for users of cotton without regard to whether the cotton is domestic or foreign sourced); see also SCHNEPF *supra* note 117, at 24 (noting that the “United States imports very little cotton,” likely creating a de facto subsidy for U.S. cotton growers). Interestingly, the arbitrator in *U.S. — Cotton* refused to consider these measures as actionable, *U.S. — Cotton*, *supra* note 1, ¶ 3.62. This suggests the possibility for repeated violations of the WTO, where measures are revoked prior to punishment, and then re-enacted, making them immune from WTO sanctions.

¹²⁸ See Charles Abbott, *Keep U.S. Cotton Subsidy as Long as Possible - Senator*, REUTERS, Sept. 8, 2005.

¹²⁹ H.R. REP. NO. 109–276, at 7 (2005).

¹³⁰ See Press Release, U.S. Dep't of Agric., *USDA Announces Changes to Export Credit Guarantee Programs to Comply with WTO Findings* (June 30, 2005).

¹³¹ See Walker & Abbott, *supra* note 115 (quoting Secretary of Agriculture Mike Johanns who stated that “[w]e're going to comply with the WTO ruling”); see also Charles Abbott & Sophie Walker, *U.S. Plans End of Cotton Subsidy Outlawed by WTO*, REUTERS, July 1, 2005 (quoting USDA Undersecretary J.B. Penn who stated “[w]e think this package. . . will bring us into compliance”).

¹³² See S. REP. NO. 110–220, at 90–91 (2007) (asserting that elimination of Step-2, the changes to the export credit guarantees and that the minor changes in the ML

the programs for changes or elimination strongly suggests the United States sought to comply with portions of the WTO rulings.¹³³

The changes are also attributable to the different *legal* status of the payments under WTO law. The SCM Agreement distinguishes between “prohibited” export and domestic content subsidies,¹³⁴ and “actionable subsidies” that are only illegal if they are shown to have “adverse effects” on other members.¹³⁵ The Step-2 and export credit guarantee payments were deemed by the WTO to be prohibited export subsidies¹³⁶ while the ML and CC payments were found to be illegal actionable subsidies because they depressed global markets.¹³⁷ The U.S. inaction on ML and CC payments may be a product of the legal ambiguity concerning actionable subsidies, compared to the straightforward prohibition against export subsidies, thus prompting changes to the latter. Additionally, the SCM Agreement imposes shorter timelines for removing prohibited subsidies.¹³⁸

In short, the best explanation for the changes to export credit guarantees and elimination of Step-2 is a desire to comply with the WTO rulings and prevent continued violations of U.S. trade commitments. While this helps explain the elimination of Step-2 and changes to the export credit guarantees, it fails to explain why the WTO rulings failed to induce compliance with the ruling that the CC and ML payments were also illegal under the WTO.

and CC payments “as a whole constitute sufficient and adequate compliance by the United States in the [U.S. — *Cotton*] dispute. It is the view of the Committee that no other changes should be necessary to satisfy a compliance panel in the WTO”); see also H.R. REP. NO. 110-627, at 758 (2008) (Conf. Rep.) (“the [m]anagers believe that the changes in this section satisfy U.S. commitments to comply with the Brazil cotton case with regard to the export credit guarantees.”).¹³³ That Step-2 was the only program eliminated in Budget Reconciliation suggests the timing and choice was driven by WTO concerns, see H.R. REP. NO. 109-362, at 187-94 (2005) (Conf. Rep.) (describing the cuts to USDA programs).

¹³⁴ See SCM Agreement, *supra* note 2, art. 3.

¹³⁵ See *id.* art. 5.

¹³⁶ See *U.S. — Cotton*, *supra* note 1, ¶ 1.2 (discussing the previous Appellate Body holding that Step-2 and export guarantees were prohibited subsidies within meaning of SCM Article 3); see also SCM Agreement, *supra* note 2, art. 3.

¹³⁷ See *U.S. — Cotton*, *supra* note 1, ¶ 1.2 (discussing the previous Appellate Body holding that ML and CC payments were actionable subsidies creating significant price suppression within meaning of SCM Article 6.3(c)); see also SCM Agreement, *supra* note 2, art. 6.3(c).

¹³⁸ Compare *id.* art. 4.7 (removal “without delay” upon finding of prohibited subsidy), with *id.* art. 4.12 (requiring compliance in half the time as specified under the DSU for other violations of the SCM Agreement); see also SCHNEPF, *supra* note 117, at 14-17 (summarizing these timelines in the *U.S. — Cotton* case and how changes are mandated to be quicker under the SCM Agreement for prohibited subsidies).

2. *The U.S. Congress Failed to Change Programs Despite the WTO Findings Where Doing so Would Require Fundamental Changes to U.S. Farm Policy*

Unlike Step-2, which was cotton-specific, and the export credit guarantees, which could be changed administratively, ML payments and CC payments are pillars of U.S. farm policy. The ML payments regulate sales of commodities, helping stabilize the price farmers receive for cotton and discouraging slumps in market prices immediately following harvest.¹³⁹ The CC payments compensate farmers if market prices fall below a specified trigger.¹⁴⁰ Both programs encourage overproduction of cotton, and because of limited domestic use of cotton, the exports help cause serious prejudice to Brazil.¹⁴¹ Unlike export credit guarantees, modifying ML and CC payments could not be done in a WTO-compliant way without undermining the very purpose they are designed to serve.

The *U.S. — Cotton* case threatens numerous farm programs outside of those supporting cotton. When the WTO's initial decision was made, it came as a shock to many in the agriculture community.¹⁴² The long-term implications remain undefined, but many view *U.S. — Cotton* as opening the door to attack numerous U.S. farm programs under the WTO.¹⁴³ American reactions to the most recent *U.S. — Cotton* decision reaffirm that Congress intends to ignore the WTO's

¹³⁹ See Shumaker, *supra* note 126, at 555 (describing ML payments); USDA Economic Research Service, *Farm and Commodity Policy: Program Provisions: Marketing Assistance Loans and Loan Deficiency Payments*, available at <http://www.ers.usda.gov/briefing/farmpolicy/malp.htm>.

¹⁴⁰ See Shumaker, *supra* note 126, at 555–56 (describing CC payments); USDA Economic Research Service, *Farm and Commodity Policy: Program Provisions: Counter-Cyclical Payments*, available at <http://www.ers.usda.gov/Briefing/FarmPolicy/countercyclicalpay.htm>.

¹⁴¹ The United States is presently the largest global exporter of cotton. For a summary of the U.S. role in global cotton trade, see SCHNEPF *supra* note 117, at 1–2.

¹⁴² See Stephanie Mercier, *The WTO and US Agricultural Policy: Intersections and Consequences*, CHOICES, 4th Quarter 2004, at 26 (stating that while the ruling was limited to cotton “it potentially has much broader implications for U.S. agricultural policy”); see also Darren Hudson, et al, *The WTO Cotton Case and US Domestic Policy*, CHOICES, 2d Quarter 2005, at 143 (asserting that the *U.S. — Cotton* case may be “an event. . . that portends to reshape agricultural policy”).

¹⁴³ E.g. Stephen J. Powell and Andrew Schmitz, *The Cotton and Sugar Subsidies Decisions: WTO's Dispute Settlement System Rebalances the Agreement on Agriculture*, 10 DRAKE J. AGRIC. L. 287, 312–15, 330 (identifying, corn, dairy, rice, soybeans, and wheat subsidies as “hardly any different” from cotton subsidies and concluding that *U.S. — Cotton* has “far reaching” consequences that “pose serious threats to United States farm policy.”). RANDY SCHNEPF, CONGRESSIONAL RESEARCH SERVICE, BRAZIL AND CANADA'S WTO CASES AGAINST U.S. AGRICULTURAL SUPPORT (Feb. 1, 2008), available at <http://www.ncseonline.org/NLE/CRSreports/>

finding that ML and CC payments are illegal under the SCM Agreement and instead Congressional leaders continue emphasizing the changes made to Step-2 and export credit guarantees while avoiding any acknowledgement that CC and ML payments require changes under the WTO.¹⁴⁴ It is far from clear that the calculations of key legislators from Arkansas, Georgia, Montana or Minnesota would have been different if a credible threat of cross-retaliation to non-agriculture interests was imminent.¹⁴⁵ Acknowledging the illegality of ML and CC payments under the WTO would call into question much of the U.S. farm support system extended under the 2008 Farm Bill.¹⁴⁶ Members of Congress would be loathe to acknowledge such inconsistency between WTO law and current U.S. farm policy.

That Congress has asserted U.S. compliance with the *U.S. — Cotton* case while failing entirely to address actionable subsidies¹⁴⁷ is tantamount to a statement that it will go no further in the dispute, regardless of the consequences under the WTO. The U.S. response to the WTO rulings on cotton programs illustrates, in summary, a desire to comply, but only where it would not produce significant pain. Some legal changes by the United States demonstrate a resolve to comply with U.S. legal obligations under the WTO, but the U.S. ignored parts of the WTO rulings calling into question fundamental farm policy choices. Given the far-reaching consequences of changing ML and CC payments, it is doubtful that cross-retaliation would have induced compliance.

B. Retaliation and Issue Linkage in Resolving Disputes in International Relations Theory and State Practice

Supporters of retaliation surmise that for developed countries whose comparative advantage is in services and intellectual property,

08Mar/RL34351.pdf (summarizing cases against U.S. farm programs brought by Brazil and Canada following the *U.S. — Cotton* case).

¹⁴⁴ See Press Release, Harkin Comments on WTO Decision on Brazil Cotton Case, (Aug. 31, 2009), available at http://216.40.253.202/~usscanf/index.php?option=com_content&task=view&id=1943&Itemid=2 (noting other changes in response to the *U.S. — Cotton* rule but not addressing ML and CC payments); Press Release, Senator Chambliss Statement on WTO Decision Against U.S. Cotton (Aug. 31, 2009) (failing to mention ML and CC payments in a summary of U.S. actions to comply).

¹⁴⁵ Cf. DAN MORGAN, *supra* note 123, at 52–53 (discussing Congressional reaction to *U.S. — Cotton* and concluding that lengthy delays for penalties under the DSB mean lawmakers “can ignore the WTO without serious consequences”).

¹⁴⁶ See generally Powell and Schmitz, *supra* note 143; 2008 Farm Bill, *supra* note 112.

¹⁴⁷ See S. REP. NO. 110–220, at 90–91 (2007) (asserting compliance with the rulings, despite failing to substantively change ML and CC payments).

linking rights under TRIPS and GATS with obligations under GATT will significantly increase compliance with the latter.¹⁴⁸ This proposition is questionable as a matter of international relations theory as well as state practice. Retaliation changes the calculus of states, but only to a limited degree. Instead, compliance is most often driven by the traditional institutional role in monitoring and clarifying when a WTO member is in breach, similar to the function of pre-WTO GATT panels.

Mainstream international relations theory assumes states are rational actors, but diverges into two broad camps that explain compliance with international obligations as a product of either underlying power disparities between states (realism)¹⁴⁹ or international regimes that coordinate cooperation between states (institutionalism), usually in an efficient manner.¹⁵⁰ Realists explain patterns of cooperation, whether or not in an institutional setting, as reflecting underlying international power structures.¹⁵¹ Institutionalists emphasize that in-

¹⁴⁸ See Andrew S. Bishop, *The Second Legal Revolution in International Trade Law: Ecuador Goes Ape in Banana Trade War with European Union*, 12 INT'L LEGAL PERSP. 1, 3, 126 (2002) (arguing that the *E.C. — Bananas* case “effectively levels the playing field between the weaker developing WTO members and the stronger industrial WTO members . . . [and] will most likely set a precedent inducing compliance”); Gabriel L. Slater, *The Suspension of Intellectual Property Obligations Under TRIPS: A Proposal for Retaliating Against Technology-Exporting Countries in the World Trade Organization*, 97 GEO. L.J. 1365, 1370 (2009) (“suspending U.S. and European IP rights offers a powerful stick in their trade with developed countries.”); see also Georgia Hamann, Note, *Replacing Slingshots With Swords: Implications of the Antigua-Gambling 22.6 Panel Report for Developing Countries and the World Trading System*, 42 VAND. J. TRANSNAT'L L. 993, 998 (2009) (stating that TRIPS retaliation “constitutes a grave threat to developed economies [by] . . . effectively exerting pressure on developed economies to either honor obligations or pay fair settlement prices”). Note here that my analysis in this section applies equally to regular retaliation and cross-retaliation although I use the term retaliation here.

¹⁴⁹ A variant of realism is the theory of hegemonic stability, which posits that the creation of international regimes, and sometimes institutions, result from the leading economic power's ability and willingness to bear the costs of them. For the original exposition of this theory in explaining the Great Depression and lack of international cooperation in monetary affairs, see CHARLES P. KINDLEBERGER, *THE WORLD IN DEPRESSION 1929–39*, 1–13 (rev. and enlarged ed. 1986). This is relevant because it predicts that when major players view the WTO legal regime as unnecessarily binding them, the multilateral trading system will be undermined.

¹⁵⁰ See JOSÉ E. ALVAREZ, *INTERNATIONAL ORGANIZATIONS AS LAW-MAKERS* 17–31 (2005) (describing institutionalists as “functionalists” and comparing institutionalist theory with realism).

¹⁵¹ See John J. Mearsheimer, *The False Promise of International Institutions*, INT'L SECURITY, Winter 1994–95, at 7.

ternational organizations facilitate information sharing, transparency and monitoring of compliance with obligations, and reducing but not eliminating obstacles to cooperation posed by power disparities.¹⁵²

Explicit in both iterations of mainstream international relations theory is that states are rational actors with pre-determined preference schedules.¹⁵³ The analogy that states act like billiard balls in international relations suggests that states' preferences are hard to alter outside of traditional power politics.¹⁵⁴ In the context of the WTO, the victim state's ability to alter trade preferences necessarily confronts disparities in international power¹⁵⁵ and the limited legal capacity conferred on the DSU to change these preferences.¹⁵⁶

The DSU's limitation that retaliation only may be employed by countries bringing complaints¹⁵⁷ also runs contrary to international relations scholarship examining when sanctions succeed in inducing compliance. One of the assumptions of this scholarship is that sanctions are often ineffective and less effective when done without multilateral support.¹⁵⁸ This scholarship examines when sanctions succeed

¹⁵² See ROBERT O. KEOHANE, *AFTER HEGEMONY COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY* 85–109 (1984). See generally Robert O. Keohane & Lisa L. Martin, *The Promise of Institutional Theory*, 20 INT'L SECURITY 1, 39–51 (1995).

¹⁵³ See generally KEOHANE, *supra* note 152, chs. 1, 5–6 (demonstrating how states as rational actors create institutions to coordinate behavior).

¹⁵⁴ See ARNOLD WOLFERS, *DISCORD AND COLLABORATION* 19–24 (1962) (using the billiard ball analogy to and noting deviations from that model in international relations before asserting that explaining state behavior requires “primary attention” to the nation-state and multistate systems).

¹⁵⁵ Mavroidis believes that while the WTO does not have a mandate to address inequalities under all circumstances, they may in the context of the dispute settlement to ensure “inequalities will not adversely affect the rights of states concerned,” Mavroidis, *supra* note 52, at 808, n.134. This is true to the extent permitted under the terms of the DSU, which restricts the size of permissible retaliations permitted, see DSU, *supra* note 7, art. 22.4, and the kind of retaliations under the “practicable” and “effective” procedures, see DSU, *supra* note 7, art. 22.3.

¹⁵⁶ See DSU, *supra* note 7, art. 22.4 (limiting the size of retaliation to that “equivalent” to the level impairment due to the violating measure); *id.* art. 22.3 (limiting the manner of retaliation and when states may resort to cross-retaliation); see generally *supra* Part II.

¹⁵⁷ See DSU, *supra* note 7, art. 23.1 (“[w]hen Members seek redress of a violation of obligations. . .they shall have recourse to, and abide by, the rules and procedures of this Understanding”).

¹⁵⁸ See Daniel W. Drezner, *Bargaining, Enforcement, and Multilateral Sanctions: When is Cooperation Counterproductive*, 54 INT'L ORG. 1, 73–102 (2000) (providing an explanation for why there has been a lack of empirical support for the assumption that sanctions are only effective when implemented multilaterally); *cf.* GARY

in changing political or security goals of states, a considerably tougher task than changing trade preferences. Linking compliance with WTO obligations to the threat of sanctions requires, at the least, that the suspension carries sufficient market power¹⁵⁹ so that it will inflict real pain on the non-compliant state.¹⁶⁰ The DSU limits the amount of pain that the victim state may apply, and arbitrators have acknowledged that economic disparities between the violating state and the victim state necessarily limit the ability of retaliations to induce compliance.¹⁶¹ The WTO's ability to induce compliance strictly through retaliation is therefore sharply limited.¹⁶²

CLYDE HUFBAUER, ET AL, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS, ECONOMIC SANCTIONS RECONSIDERED 158–75 (2007) (finding that sanctions by states since 1914 were “at least partially successful” 34% of the time, that stronger diplomatic ties between the sanctioning state and sanctioned state improve success, but also that broader multilateral support does not necessarily change this success rate); James Mayall, *The Sanctions Problem in International Economic Relations: Reflections in the Light of Recent Experience*, 60 INT'L AFF. 4, 631–42 (taking a dim view of sanctions in practice during the Cold War, particularly where diplomacy cannot ensure multilateral participation in them).

¹⁵⁹ If states are rational actors, by analogy, the antitrust concept of “tying” between two products is instructive of how difficult it will be to induce compliance through sanctions. Tying one product to another will not “force” a consumer to buy the tied product unless the seller has sufficient market power in the tying product, see *Jefferson Parish Hosp. Dist. v. Hyde*, 466 U.S. 2, 12 (1984) (holding that tying of products is not per se illegal unless there is market power in the tying product sufficient to force consumers to purchase the tied product). Here, Brazil cannot force compliance from the United States (the tied product) unless it has sufficient market power in some other sector to retaliate (the tying product). The United States thus will not change its farm policies unless Brazil can impose large and painful sanctions. The analogy is misleading because, unlike consumers in the market, states have institutionalized an entire spectrum of interactions under the WTO and are not in fact unitary actors. This analogy suggests however the rare instance when retaliation itself will bear sufficient economic power to force compliance from a state determined to resist.

¹⁶⁰ Robert E. Hudec, *Broadening the Scope of Remedies in the WTO Dispute Settlement*, in *IMPROVING WTO DISPUTE SETTLEMENT PROCEDURES ISSUES AND LESSONS FROM THE PRACTICE OF OTHER INTERNATIONAL COURTS AND TRIBUNALS* 369, 388 (Friedl Weiss ed. 2000) (“[h]opefully the economic pain caused by the retaliation will enlist the support of affected economic interests”).

¹⁶¹ See *U.S. — Gambling*, *supra* note 6, ¶¶ 4.109–16 (discussing the vulnerability of Antigua’s economic situation and its relevance in considering the practicability and effectiveness of suspending obligations within the same sector or agreement).

¹⁶² Cf. *U.S. Submission to the Arbitrator*, *supra* note 41, ¶ 341 (“[t]he DSU regime establishes remedies that could potentially be *insufficient to lead the government to comply with the DSB ruling*, but this outcome was knowingly considered and selected by Members when negotiating the DSU”) (emphasis added).

As an empirical matter, it is impossible to know when a state's compliance with a WTO panel is driven by a desire to avoid potentially painful sanctions or whether it complies because of other factors.¹⁶³ One study of compliance with GATT panels finds that, unsurprisingly, the larger economies tended to succeed more and comply less than weaker states.¹⁶⁴ In *U.S. — Cotton*, it cannot be definitively determined whether U.S. policy makers were driven to make the changes to farm programs because of the threat of sanctions or the desire to maintain international credibility and improve diplomatic relations, or a combination of these factors. There is good reason to think states often will comply with legal obligations regardless of potential sanctions.

Legal analysts generally agree that WTO panels, appellate body and arbitrator reports, like the text of the WTO agreements themselves, create a legal obligation on states not in compliance to remedy the continuing violation.¹⁶⁵ Compliance with international WTO rulings is, to a large extent, self-enforcing because of the negative long-term consequences of breach and associated reputation losses.¹⁶⁶ Robert Hudec argues that on the whole, the GATT panels were quite successful in inducing compliance, despite the absence of effective economic sanctions.¹⁶⁷ This suggests that the WTO's most effective tools are traditional institutional functions such as monitor-

¹⁶³ Cf. ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 359 (1990) (“one can never really *prove* that an international legal institution has made a difference”).

¹⁶⁴ See *id.* at 355.

¹⁶⁵ Mavroidis, *supra* note 52, at 782; see also; John Jackson, *The WTO Dispute Settlement Understanding—Misunderstandings on the Nature of Legal Obligation*, in DISPUTE RESOLUTION IN THE WORLD TRADE ORGANIZATION 69 (James Cameron & Karen Campbell eds., 1998); but see Schwartz & Sykes, *supra* note 31, at §189 (arguing that the WTO members are not obliged to comply with rulings).

¹⁶⁶ HUDEC, *supra* note 163, at 361 (discussing compliance with GATT panels where no effective sanctions were employed, concluding that “[t]he main impact [of GATT rulings] comes from a series of events that, on the one hand, communicate the international community’s condemnation with increasing clarity and authority, and, on the other hand, create repeated occasions upon which the government’s policy must be reviewed and may be changed”).

¹⁶⁷ *Id.* at 353 (finding “the overall success rate of 88 percent” for GATT panels); see Hudec, *supra* note 160, at 400 (closing a discussion of remedies by saying that “[t]he ultimate ‘remedy’ which made the GATT dispute settlement procedure as successful as it was the force of community pressure . . . that can be generated without an elaborate structure of remedial procedures”). Compliance with WTO reports similarly has been strong, see generally Bruce Wilson, *Note, Comment and Development, Compliance by WTO Members With Adverse WTO Dispute Settlement Rulings: The Record to Date*, 10 J. INT’L ECON. L. 397 (2007).

ing state behavior, clarifying legal obligations, and legitimizing retaliatory actions in the face of a trade partner's continued breach.¹⁶⁸

The question is how significantly increased retaliation, including cross-retaliation, adds to the likelihood of compliance with WTO rulings.¹⁶⁹ It cannot be denied that an institutionalized regime of sanctions may increase compliance over the medium-to-long term, and possibly induce liberal trade policies in situations where it otherwise would not occur.¹⁷⁰ The improved compliance will likely be marginal, however,¹⁷¹ and must be considered in light of the associated drawbacks of increased sanctions. Countervailing considerations include distracting from multilateral economic liberalization,¹⁷² unleashing domestic protectionist lobbying in the victim state,¹⁷³ and enhancing larger states economic power in the DSU.¹⁷⁴ Limiting cross-retaliation to situations where the victim state has little trade with the violating state will usually prevent DSU Article 22.3 from becoming a tool of the powerful against the weak because, on the whole, weak states

¹⁶⁸ See Kenneth W. Abbott & Duncal Snidal, *Why States Act Through Formal International Organizations*, 42 J. CONFLICT RES. 1, 16–23 (1998) (identifying independence as a key reason why states act through formal international organizations rather than ad hoc legal regimes without such organizations); Judith Goldstein & Lisa L. Martin, *Legalization, Trade Liberalization, and Domestic Politics: A Cautionary Note*, 52 INT'L ORG. 3, 603, 608–09 (2000) (noting that “precision” concerning legal requirements is a key function of trade liberalization). See generally HUDEC, *supra* note 163, at 357–72 (assessing why states complied with GATT panels).

¹⁶⁹ Compare HUDEC, *supra* note 163, at 353 (noting a study finding a compliance rate of 88 percent under GATT dispute panels), with Judith L. Goldstein & Richard H. Steinberg, *Negotiate or Litigate? Effects of WTO Judicial Delegation on U.S. Trade Politics*, 71 LAW & CONTEMP. PROBS. 257, 275 (noting a study finding a 95 percent compliance rate with WTO rulings as of 2007).

¹⁷⁰ See generally Goldstein & Steinberg, *supra* note 169 (arguing that WTO decisions affect domestic interest in ways that may encourage liberalization not possible through traditional negotiations).

¹⁷¹ HUDEC, *supra* note 163, at 363 (assessing increased retaliation “higher costs of resistance” as unlikely “to have much political impact”).

¹⁷² Charnovitz, *supra* note 14, at 832 (arguing that sanctions may be “distracting attention from the task of economic liberalization”); Shumaker, *supra* note 126, at 602 (asserting that the long-term consequences of Brazil's victory in the WTO is likely to undermine efforts to reduce barriers to trade).

¹⁷³ See Charnovitz, *supra* note 14, at 814–18 (discussing the painful effects on the imposing state, and noting domestic industry lobbying efforts to have protection afforded to them through sanctions).

¹⁷⁴ HUDEC, *supra* note 163, at 363 (“higher costs of resistance will be most effective as a deterrent against non-compliance by those relatively smaller countries”).

have less trade than larger developed countries.¹⁷⁵ Under the standard proposed here, the opportunity to cross-retaliate usually will remain open to small states against larger ones.

The increased limits of the proposed standard often would benefit developing countries while sacrificing only marginal gains in increased compliance with WTO rulings. The compliance-inducing benefits of the WTO are unlikely to be significantly enhanced through more cross-retaliation, although the drawbacks may be substantial.

V. CONCLUSION

While inducing compliance with WTO obligations is a central tenant of the DSU, it is not the exclusive purpose. This paper suggests inducing compliance through retaliation will often be difficult and also argues that the *U.S. — Cotton* decision stretches the standard under the DSU to a legally distorted position. The *U.S. — Cotton* case also shows that a sense of legal obligation spurs change, but only to a point. When there is significant trade between countries under the agreement breached, there is good reason to think that the compliance inducing effects of the WTO will succeed or fail regardless of the victim state's ability to retaliate. Instead of focusing solely on inducing compliance, WTO arbitrators should look at the level of trade between the victim and violating state. This is consistent with the overall purpose of the DSU to both enable and constrain state retaliation and remains true to the legal standard established by treaty makers in creating DSU Article 22.3.

¹⁷⁵ Of course, under the proposed standard it could still be used by powerful IP exporting countries against weak states where the weak state exports no goods or services protected under TRIPS. This was the situation envisioned when DSU Article 22.3 was originally proposed, see CROOME, *supra* note 56, at 112–14, 244, 279–83.