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THE NEGLECTED LINK BETWEEN THE LEGAL NATURE OF  
WTO RULES, THE POLITICAL FILTERING OF WTO  
DISPUTES, AND THE ABSENCE OF RETROSPECTIVE WTO  
REMEDIES

CLAUS D. ZIMMERMANN\*

*This note examines the shortcomings of the conventional analysis of why the WTO's dispute settlement mechanism has not been equipped with retrospective remedies. In doing so, this note examines the neglected link between the underlying legal nature of WTO rules as international obligations of result instead of conduct, the ex ante governmental filtering of WTO disputes, and the absence of retrospective remedies at the WTO. The two key findings of this note are as follows. First, in addition to the increasing complexity of WTO law, it is the underlying nature of WTO rules as international obligations of result that renders this part of international economic law particularly prone to good-faith breaches. Second, in light of the fact that individual WTO members are in a position where they may interpose themselves as political filters of potential disputes, equipping such a system with retrospective remedies would significantly raise the cost of breach, thereby eroding the economic benefits of the current system of prospective remedies. Therefore, by lowering the cost of not only good-faith breaches but of breach in general, the prospective nature of WTO remedies creates an important incentive for WTO members to participate in future rounds of trade liberalisation. Furthermore, the absence of retrospective remedies encourages WTO members to litigate disputes through to formal findings, thereby producing an important positive externality in the form of valuable clarifications of the complex legal framework applicable to all WTO members. Considering that the WTO's poor and small members are more likely to commit good-faith breaches of the WTO Agreement, the absence of retrospective remedies is in line with strong efforts by the WTO to level the playing field between its members and to provide all of its members with equal opportunities in the context of WTO dispute settlement. Overall, it emerges that the existing prospective nature of WTO dispute settlement has served the international trading system rather well. A switch to retrospective remedies may do more harm than good.*

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## I. INTRODUCTION

Dispute settlement under the rules of the World Trade Organization [WTO]<sup>1</sup> offers complainant members merely with the possibility to obtain prospective relief, that is, the withdrawal of a contested measure. The rules laid down in the WTO's Dispute Settlement Understanding [DSU]<sup>2</sup> do not provide for the reparation of past losses, *i.e.*, retrospective compensation for the economic harm a member suffered from a WTO-inconsistent measure. Under the existing system, compensation and the suspension of concessions merely provide for the rebalancing of mutual trade concessions in case the respondent member continues to be in noncompliance after the expiry of the 'reasonable period of time' as determined under DSU Article 21.3.<sup>3</sup> As per DSU Article 22.1, both compensation and the suspension of concessions are merely temporary measures with compliance remaining the ultimate goal of WTO dispute settlement.

This note addresses the shortcomings of the conventional explanation for why the drafters of the WTO agreements decided not to provide for the imposition of

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<sup>1</sup> The WTO came into being with the successful completion of the Uruguay Round of multilateral trade negotiations and entry into force on 1 January 1995 of the Marrakesh Agreement Establishing the World Trade Organization [WTO Agreement], signed on 15 April 1994. For the complete WTO treaty framework, *see* WTO SECRETARIAT, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS, THE LEGAL TEXTS (WTO & Cambridge Univ. Press, 1999) [hereinafter LEGAL TEXTS], also available at: [http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm](http://www.wto.org/english/docs_e/legal_e/legal_e.htm).

<sup>2</sup> Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, Annex 2, *in* LEGAL TEXTS, *supra* note 1, at 354.

<sup>3</sup> This 'reasonable period of time' which, according to DSU Article 21.3, the respondent may be accorded if it is 'impracticable to comply immediately with the recommendations and rulings' of the WTO Dispute Settlement Body [DSB], will be determined either by mutual agreement between the parties and approval by the DSB or through binding arbitration. As determined by DSU Article 22.2, if the inconsistent measure is not withdrawn within the 'reasonable period of time', complainant and respondent must negotiate over compensation. Although the DSU does not forbid that such compensation be pecuniary in nature, compensation usually takes the form of an equivalent lifting of trade barriers by the WTO member found to be in noncompliance.

retroactive sanctions and the reparation of past losses. The note proceeds as follows. Part II provides a brief overview of the conventional analysis of the lack of retrospective remedies in WTO dispute settlement. Thereafter, this note focuses on the main neglected factors in the conventional analysis of the lack of retrospective WTO remedies. Thus, Part III examines the implications of the underlying legal nature of WTO rules as international obligations of result rather than of conduct. Part IV reconsiders the absence of retrospective WTO remedies in light of the *ex ante* political filtering of WTO disputes that occurs in a system which lacks centralised dispute initiation. Part V concludes.

## II. THE CONVENTIONAL ANALYSIS OF THE LACK OF RETROSPECTIVE WTO REMEDIES

Under the existing rules of the DSU, if the WTO member found to be in noncompliance withdraws the inconsistent measure by the end of the ‘reasonable period of time’ for implementation as determined according to DSU Article 21.3, the matter is deemed to be fully resolved. The member concerned is not obliged to provide any sort of reparation for past damages caused by its WTO-inconsistent measure(s).<sup>4</sup> However, if an inconsistent measure is not withdrawn within the ‘reasonable period of time’, the respondent is required to negotiate with the complainant over compensation. Under the detailed rules of DSU Article 22, the complainant may be authorised by the DSB to proceed to trade retaliation only if these negotiations fail. In addition, the volume of the retaliation in question may not exceed the level of nullification or impairment caused to the claimant by the breach at issue.<sup>5</sup> Most importantly, the level of trade retaliation authorised by the DSB will be set by counting only from the date of expiry of the ‘reasonable period of time’ for implementation of the DSB’s recommendations or rulings. Therefore, the relief is restricted, at best, to some form of a prospective measure for the complainant, who will be authorised ‘to shoot itself in the foot’ by temporarily

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<sup>4</sup> It should not be overlooked, however, that on a few rare occasions, panels, mostly under the former GATT, have recommended the reimbursement of wrongfully collected antidumping duties, thus providing for some retrospective relief for successful complainants. For detail, see Petros C. Mavroidis, *Remedies in the WTO Legal System: Between a Rock and a Hard Place*, 11(4) EUR. J. INT’L L. 763, 775-7 (2000). For related insightful analysis, providing various references to relevant disputes (mostly under the former GATT) in which limited retrospective relief was granted, see also Joel P. Trachtman, *The WTO Cathedral*, 43 STAN. J. INT’L L. 127, 132-41 (2007).

<sup>5</sup> Trade retaliation as authorised by the DSB is therefore also frequently referred to by the term ‘proportional countermeasures’. In accordance with the existing literature, this note uses the terms ‘trade retaliation’ and ‘countermeasures’ as synonyms in order to designate the ‘suspension of concessions and other obligations’ that may be authorised by the DSB in accordance with the rules set forth in DSU Article 22.

raising trade barriers against the respondent.<sup>6</sup> Hence, the essential benefit a WTO member may obtain from initiating a WTO dispute is delayed cessation of the treaty violation, and compensation *ex tunc* (i.e., counting from the expiry of the ‘reasonable period of time’) but no reparation for past losses.

Alan Sykes has described the dilemma that arises from this state of affairs as follows: ‘One might argue that such a system encourages cheating because there is no penalty for it unless the cheater is caught and still refuses to stop within a “reasonable time”. No fully satisfactory explanation for this aspect of the system exists[.]’<sup>7</sup> Indeed, the conventional analysis of the lack of retroactive sanctions in WTO dispute settlement essentially amounts to a discussion of the economic costs and benefits of switching to retrospective remedies as compared to the existing prospective design of WTO dispute settlement. On the one hand, there is little doubt that introducing a credible threat of retrospective sanctions into the system would create a big incentive towards compliance by forcing WTO members to internalise a bigger proportion of the total cost of breach.<sup>8</sup> On the other hand, the existing literature has convincingly explained why it is plausible to assume that retrospective remedies were renounced by the drafters of the WTO Agreement in order to secure the following major benefits for the international trading system.

*First*, the fact that the rules of the DSU do not provide for the reparation of past losses but are limited to ensuring prospective relief, has been rightly analysed as making an important contribution to promoting the role ascribed to the WTO’s dispute settlement mechanism by DSU Article 3.2 which underlines the dispute settlement mechanism’s role as a ‘central element in providing security and predictability to the multilateral trading system [serving] to preserve the rights and obligations of [WTO m]embers under the covered agreements’. As argued by Schwartz and Sykes in what the authors themselves refer to as a ‘speculation’: [M]any (although not all) [WTO] disputes ... involve good-faith clashes over ambiguous terms of the bargain. In these circumstances, countries are often genuinely uncertain about what they are obliged to do, and sanctions may have the effect of punishing them for good-faith behaviour. ... [T]here may be instances in which WTO provisions have been intentionally left vague ... A country found to

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<sup>6</sup> For detail on this line of thought, see Joost Pauwelyn, *Enforcement and Countermeasures in the WTO: Rules are Rules – Toward a More Collective Approach*, 94(2) AM. J. INT’L L. 335, 337–8 (2000) and additional references quoted therein.

<sup>7</sup> Alan O. Sykes, *Public vs. Private Enforcement of International Economic Law: Of Standing and Remedy*, John M. Olin Law & Economics Working Paper No. 235 (2005), at 8 [hereinafter Sykes].

<sup>8</sup> This is due to the fact that under a treaty framework equipped with retrospective sanctions, the breaching party, when deciding whether or not to violate a specific treaty obligation, cannot simply ignore the damages it thereby causes to the other party over the period of time prior to a formal finding of breach.

be in violation of such obligations after the fact may thus have provided a public good by becoming the test case on a particular issue. The absence of sanctions for behavior prior to an adverse ruling may thus be seen as a way to encourage nations to litigate their disputes to conclusion so as to clarify the rules for everyone.<sup>9</sup>

In other words, Schwartz and Sykes point out that the existing absence of a right for reparation of past losses invites WTO Members to litigate their disputes through all procedural stages to formal and final findings, which may benefit the entire international trading system. They convincingly analyse that the clarification of very complex treaty rules which may be obtained only when disputes are litigated to a formal conclusion, amounts to an important positive externality for all other WTO members.<sup>10</sup> These other WTO members, though they may not have been directly involved in the dispute at hand as a party or as a third party, are nevertheless subject to the same legal framework and will therefore benefit, as a group and individually, from the obtained clarification in the future.

*Second*, the absence of retrospective WTO remedies may contribute to levelling the playing field between the WTO's poor and rich members by promoting the objective of the WTO's dispute settlement mechanism to provide equal opportunities for all members of the organization. This proposition is grounded in the assumption that poor and small WTO members, due to various capacity constraints faced by them, such as a lack of the necessary resources for lengthy and costly litigation, as well as a certain lack of legal know-how with regard to what has become an increasingly complex and sophisticated legal system,<sup>11</sup> are more likely to commit good-faith breaches of the WTO Agreement than the WTO's rich members. If this is true, which seems highly plausible, then the current prospective nature of WTO remedies may indeed help to ensure that existing disadvantages faced by the WTO's small and poor members are not compounded.

*Third*, and most important, it has been argued in the existing literature that the absence of retrospective remedies, by lowering the cost not only of good-faith breaches of WTO law but of breach in general, may encourage WTO members to participate in ambitious future rounds of trade liberalisation. In other words, reducing the cost of treaty violations, committed for whatever reason, may provide an important incentive for states to subscribe to what is a highly complex treaty

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<sup>9</sup> Warren Schwartz and Alan O. Sykes, *The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization*, 31(1) J. LEGAL. STUD. 179, 201 (2002) [hereinafter Schwartz and Sykes].

<sup>10</sup> See Sykes, *supra* note 7, at 8.

<sup>11</sup> For a highly insightful analysis on how capacity constraints affect the WTO's small and poor members in WTO dispute settlement with regard to their choice of respondents, see Andrew T. Guzman & Beth A. Simmons, *Power Plays and Capacity Constraints: the Selection of Defendants in WTO Disputes*, 34(2) J. LEGAL. STUD. 557 (2005).

framework with an increasingly voluminous body of sophisticated jurisprudence. Government officials deciding whether or not to subscribe to further trade liberalisation simply cannot foresee all potential changes in their domestic circumstances. These include changing economic conditions and evolving political preferences as well as varying degrees of pressure from domestic interest groups that may render it impossible for the officials, at least temporarily, to comply with a specific WTO obligation.<sup>12</sup> If the cost of breach within a given treaty framework is perceived as being too high, it is plausible to expect that the same government officials will refrain from agreeing to further trade liberalisation in the first place.

In light of the above considerations, the absence of retrospective remedies in WTO dispute settlement may be regarded as creating significant long-term benefits for the world trading system. However, the existing literature appears to have neglected the importance of the legal nature of WTO rules as international obligations of result, as well as the fact that the governments of individual WTO members are in a position where they may effectively interpose themselves as political filters *ex ante* of WTO disputes. In order to fully understand why the WTO's dispute settlement mechanism has been designed to provide only prospective relief, it is of crucial importance to take these factors into account.

The following section aims to shed light on the first of these neglected factors. The increasing complexity of WTO law with its ever-growing body of highly technical jurisprudence and the various capacity constraints faced by WTO members plausibly support the conventional wisdom that many violations of WTO rules occur in good faith. However, it will be argued in this section that the main reason why WTO law is particularly prone to good-faith breaches compared to other rules of international law – thus justifying the system's prospective nature – is rooted in the underlying nature of WTO rules as international obligations of result instead of conduct.

### III. FIRST NEGLECTED FACTOR: THE UNDERLYING LEGAL NATURE OF WTO RULES

In order to fully understand the underlying legal nature of WTO rules, it is helpful to compare the nature of the rights and obligations under the WTO Agreement with those flowing from the constituent treaty of another important international organisation in the realm of international economic relations, the

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<sup>12</sup> See JOOST PAUWELYN, *OPTIMAL PROTECTION OF INTERNATIONAL LAW* 157–63 (Cambridge Univ. Press 2008). See also Claus D. Zimmermann, *Toleration of Temporary Non-Compliance: The Systemic Safety Valve of WTO Dispute Settlement Revisited*, 3(2) *TRADE, L. & DEV.* 382 (2011) and additional references cited therein.



Articles of Agreement of the International Monetary Fund ('IMF Agreement').<sup>13</sup>

The most significant conceptual difference between WTO rules and the legal framework of the IMF concerns the manner in which the motives underlying a contested policy or measure are taken into account, if at all. When it comes to deciding whether a WTO member has breached its obligations towards another member under a specific WTO rule, the competent dispute settlement panel will exclusively be interested in examining the objective effects of clearly identified governmental measures in the sense of DSU Article 3.3. The intention behind these measures, *i.e.*, the objectives that the respondent pursued in implementing the said measures is irrelevant for this assessment. Hence, it seems appropriate to regard obligations under the WTO agreements, such as the prohibition of export subsidies under Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures ('SCM Agreement')<sup>14</sup> or the National Treatment principle under Article III of the GATT 1994,<sup>15</sup> as international 'obligations of result'.

By contrast, under key rules of the IMF Agreement, such as the code of conduct enshrined in IMF Article IV:1,<sup>16</sup> the 'intent' with which IMF members pursue specific policies or take specific actions plays a much greater role. The outstanding example is Article IV:1(iii) which obliges IMF members to 'avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members'.<sup>17</sup> Finding an IMF member in breach of this provision does not even require that that member managed to effectively prevent balance of payments adjustment or that it gained a measurable competitive advantage through exchange rate manipulation. It is the *intention* ('in order to') to

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<sup>13</sup> Articles of Agreement of the International Monetary Fund, 60 STAT. 1401, 2 U.N.T.S. 39 (Jul. 22, 1944) (*amended effective* Mar. 3, 2011), *available at*: [www.imf.org/external/pubs/ft/aa/index.htm](http://www.imf.org/external/pubs/ft/aa/index.htm) [hereinafter IMF Agreement]. The IMF Agreement, which entered into force on Dec. 27, 1945, was adopted on Jul. 22, 1944, at the United Nations Monetary and Financial Conference held at Bretton Woods, New Hampshire, United States.

<sup>14</sup> Agreement on Subsidies and Countervailing Measures, Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, Annex 1A, *in* LEGAL TEXTS, *supra* note 1, at 231.

<sup>15</sup> General Agreement on Tariffs and Trade 1994, Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, Annex 1A, *in* LEGAL TEXTS, *supra* note 1, at 17.

<sup>16</sup> For a detailed study of the IMF's code of conduct as enshrined in IMF Article IV:1 and of the bilateral surveillance mechanism that the IMF has set up for monitoring compliance with this provision which has proven more or less inoperable in practice, *see, e.g.*, Claus D. Zimmermann, *Exchange Rate Misalignment and International Law* 105(3) AM. J. INT'L L. 423, 427-37 (2011).

<sup>17</sup> IMF Agreement, *supra* note 13, Article IV:1(iii), underlining added.

engage in the explicitly specified beggar-thy-neighbour policies that is prohibited, independent of the actual extent to which a given member succeeds in achieving the unfair results which it is aiming for.<sup>18</sup> Hence, it appears appropriate to qualify not only the ‘soft’ obligations regarding ‘domestic’ policies under IMF Article IV:1(i) and (ii)<sup>19</sup> but also the seemingly ‘hard’ obligation under IMF Article IV:1(iii) as international ‘obligations of conduct’.

The above comparison shows that, while it is literally impossible to breach key rules of the IMF Agreement such as IMF Article IV:1(iii) in good faith, WTO rules, due to their underlying nature as international obligations of result are much more likely to be violated in good faith. Hence, in focusing on the complex nature of WTO rules (many of which are indeed characterised by constructive ambiguity) when submitting that many breaches of WTO law may occur in good faith, the existing literature provides an explanation that is incomplete. At least arguably, the more important reason for why WTO rules are particularly prone to good faith breaches is their underlying legal nature as obligations of result. This confirms that the comparatively high likelihood of good-faith breaches is an inherent key characteristic of the WTO legal framework. This, in turn, indicates that the drafters of the WTO Agreement deliberately renounced retrospective remedies in light of the above-discussed benefits that flow from the prospective nature of the current system.<sup>20</sup>

Another key characteristic of the WTO legal framework which is intrinsically related to the above and is equally relevant for the present analysis of the prospective nature of WTO remedies is that the rights and obligations created by the WTO agreements flow horizontally, i.e. between WTO members.<sup>21</sup> In other

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<sup>18</sup> See François Gianviti, *Stabilité et Manipulation des Taux de Change*, in LE DROIT INT'L ECONOMIQUE A L'AUBE DU XXIEME SIECLE 113, 126 (Jean Marc Sorel ed., Paris A. Pedone 2009).

<sup>19</sup> IMF Agreement, *supra* note 13, Article IV:1(i) and (ii), under which each IMF Member shall:

- i. endeavor to direct its economic and financial policies towards the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances; [and]
- ii. seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions[.]

<sup>20</sup> See Part II of this note, *supra*.

<sup>21</sup> It should be acknowledged that, in addition, there are some obligations that flow vertically between the WTO as an institution and its members, e.g., the obligation for WTO members under Article 25 of the SCM Agreement to notify to the WTO on a yearly basis the entire set of subsidies that fall within the scope of Article 1.1 of the SCM Agreement. Although these notification requirements are important, they are of minor significance

words, whenever a WTO member breaches a specific obligation under one of the agreements, its trading partners have a legal claim against it due to the violation of their individual legal rights guaranteed under international law. Providing WTO members with the powerful possibility of seeking the withdrawal of contested measures can be regarded as a logical consequence of the horizontal flow of rights and obligations under WTO law.

The situation at the IMF is again distinctly different. The rights and obligations set forth in the IMF Agreement exist only as between every IMF member and the IMF as an institution, and not horizontally between IMF members.<sup>22</sup> This vertical flow of rights and obligations has significant consequences and explains why the IMF, contrary to the WTO, does not need an elaborate dispute settlement mechanism.<sup>23</sup> Violations of the IMF Agreement do not give rise to legal claims for individual IMF members against each other. For instance, the above-mentioned obligation for IMF members under IMF Article IV:1(iii) to refrain from manipulating their exchange rates in order to gain an unfair competitive advantage over other members is owed by each IMF member to the IMF as an institution, but not to other members bilaterally. It is therefore important that clear-cut mechanisms exist in the IMF legal framework to ensure that the IMF's governing body, the Executive Board, becomes aware of instances of alleged breach. This is achieved by Rule K-1 of the IMF's *By-Laws, Rules and Regulations*,<sup>24</sup> according to which the IMF's Managing Director is required to bring instances of breach of obligation to the Executive Board. In addition, any individual executive director

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compared to the major obligations under the WTO agreements that flow only between WTO members.

<sup>22</sup> This position has always been adhered to by the IMF itself and has been defended in large parts of the literature. *See, e.g.*, KERN ALEXANDER, RAHUL DHUMALE & JOHN EATWELL, *GLOBAL GOVERNANCE OF FINANCIAL SYSTEMS: THE INTERNATIONAL REGULATION OF SYSTEMIC RISKS* 89, 90 (Oxford Univ. Press 2006).

<sup>23</sup> In the absence of a dispute settlement mechanism, IMF Article XXVI:2 merely provides for three limited sanctions that may be imposed for breaches of the IMF Agreement: (i) ineligibility to use the Fund's resources, (ii) suspension of voting rights, and (iii) expulsion from the Fund. It goes without saying that to actually apply these sanctions is economically and politically very sensitive. However, the draconian options under IMF Article XXVI:2 are not the only means at the IMF's disposal to ensure that its members comply with their obligations. The three pillars of the IMF's toolset – conditionality, surveillance, and technical assistance – give the IMF many subtle possibilities, combined with peer pressure, to motivate a member to change a contested policy without even having to formally prove a breach of obligation by that member. For a succinct assessment of the Fund's role as the enforcer of the international law of exchange arrangements, *see, e.g.*, Robert M Barnett, *Exchange Rate Arrangements in the International Monetary Fund: the Fund as Lawgiver, Adviser, and Enforcer*, 7 *TEMP. INT'L & COMP. L.J.* 77, 89-92 (1993).

<sup>24</sup> INTERNATIONAL MONETARY FUND, *BY-LAWS, RULES AND REGULATIONS*, Rule K-1 (58<sup>th</sup> ed., IMF 2001).

may, at any time, bring a complaint to the attention of the Executive Board, or the board itself may place a specific matter on its own agenda.<sup>25</sup>

For the purposes of the present analysis, these contrasting IMF and WTO standards can be coherently commented on in the following manner. On the one hand, the much stronger focus on conduct enables the IMF, at least in theory, to intervene at an early stage in order to safeguard systemic stability. The IMF Executive Board is not required to wait until certain exchange rate policies or misguided economic and financial policies of one of the institution's members negatively affect the stability of the international monetary system before intervening with more or less stringent advice on adjustments as it deems necessary. This is of crucial importance since, as explained above, IMF members do not have legal claims against each other based on alleged violations of the IMF Agreement. On the other hand, the fact that most obligations under the IMF's code of conduct as enshrined in IMF Article IV:1 are framed as soft 'obligations of conduct' expresses a much greater degree of deference with respect to domestic regulatory autonomy than is the case under the WTO Agreement.

The situation at the WTO is distinctly different: the legal framework of the WTO, with its strict result-oriented approach, does not treat policies differently depending on their domestic or external nature. This is due to the fact that the primary focus of the WTO legal framework is to achieve a gradually increasing liberalisation of international trade by way of regular rounds of renegotiation of mutual trade concessions. WTO members have granted each other increased market access for the price of stronger scrutiny of their domestic policies. Under the WTO legal framework, the focus is on ensuring that WTO members do not engage in trade-distortive measures with respect to other members, *i.e.*, in measures that put another member at a competitive disadvantage without having any immediate impact on the stability of the economic system as a whole. WTO Members are aware that if another member breaches a specific WTO rule, they will not only have a legal claim against that fellow member, but will also be able to rely on an efficient dispute settlement mechanism in order to seek legal redress. Hence, contrary to what is the case with the international monetary system, it could be argued that the WTO as an institution can afford to wait until specific measures show adverse effects before providing clarification on a contested issue via its dispute settlement mechanism.

Overall, the analysis provided in this section strongly supports the view that the drafters of the WTO Agreement made a coherent choice when equipping the

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<sup>25</sup> It should be noted that, in practice, this appears to have happened only rarely. See Deborah Siegel, *Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreement*, 96 AM. J. INT'L L. 561, fn. 14 (2002).

WTO's dispute settlement mechanism only with *prospective* remedies. Contrary to international obligations that flow vertically, such as in the IMF legal framework, WTO rules are not subject to permanent institutional monitoring aimed at rectifying potential instances of breach as quickly as possible.

This state of affairs may very well lead to situations where a measure breaching the WTO Agreement has been in place for many years prior to being subject to dispute settlement. Now, if one adds the increased likelihood of good-faith breaches to the picture, as arising from the underlying nature of WTO rules as international obligations of result instead of conduct, it becomes apparent that WTO remedies of a *retrospective* nature would have excessively increased the cost of breach for the respondent member, and would have undermined the economic benefits of the *prospective* design of the current system as discussed earlier.<sup>26</sup>

#### IV. SECOND NEGLECTED FACTOR: THE POLITICAL FILTERING OF WTO DISPUTES

The WTO's dispute settlement mechanism has a fundamentally intergovernmental nature, which implies that, in principle, only the governments of WTO members have access to the system, either as parties or as third parties.<sup>27</sup> Non-governmental actors, by contrast, independent of their potentially high interest and stake in a dispute regarding an alleged violation of a provision contained in any of the WTO agreements, do not have direct access to the system and are refused standing.<sup>28</sup>

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<sup>26</sup> See Part II of this note, *supra*.

<sup>27</sup> Concerning the rights of third parties during the panel stage, see DSU, *supra* note 2, Article 10.2; with regard to third participants in an appeal, see DSU Article 17.4.

<sup>28</sup> Submitting an *amicus curiae* brief is the only, albeit very limited, possibility for private persons, notably non-governmental organizations ('NGOs'), to get involved in WTO disputes. For an insightful analysis of the evolution of WTO jurisprudence on this issue, see Henry S. Gao, *Amicus Curiae in WTO Dispute Settlement: Theory and Practice*, 1 CHINA RTS. F. 51-7 (2006). At present, *amicus curiae* briefs continue to be a highly contested issue among WTO members, in particular with respect to proceedings before the WTO's Appellate Body. In practice, *amicus curiae* briefs have played hardly any role in WTO dispute settlement. For detail on this point, see Hervé Ascensio, *L'amicus curiae devant les juridictions internationales*, 4 REVUE GENERALE DE DROIT INT'L PUB. 897, 910 (2001); Petros C. Mavroidis, *Amicus Curiae Briefs Before The WTO: Much Ado About Nothing*, Jean Monnet Working Paper No. 2/01 (2001). The marked opposition of most WTO members against the admission of *amicus curiae* briefs in WTO dispute settlement proceedings has been explicitly expressed at an extraordinary meeting of the WTO General Assembly on 22 November 2000. For the minutes of this session, see WT/GC/M/60, available at: <http://docsonline.wto.org>. Many WTO members, developing country members, in particular, continue to be highly concerned about opening the WTO dispute settlement mechanism to any sort of participation by private persons. Capacity constraints have always

It has been suggested by the public choice literature that WTO members have deliberately chosen not to grant standing to foreign exporters in WTO dispute settlement proceedings in order to put themselves in a position where they can act as political filters *ex ante*, thus renouncing those cases for which the political cost would exceed the potential political gains.<sup>29</sup> As phrased by Sykes, '[states] view any reduction in their own trade barriers, and the attendant price of their imports, as a "concession" that is only tolerable in return for concessions by trading partners'.<sup>30</sup> After pointing out that not all import-competing industries are equally well organised, Sykes explains that 'an exchange of reciprocal promises [among governments] to forego enforcement on behalf of poorly-organised industries can leave both sides at a considerably higher level of utility', which means that there would be no enforcement of international trade rules whenever 'the political utility gain to officials in the violator state "outweighs" the political utility loss to officials in the state harmed by the violation'.<sup>31</sup>

However, as has been explained in detail elsewhere,<sup>32</sup> whereas public choice theory, with its narrow focus on the political welfare of government officials, convincingly explains the incentives faced by the governments of WTO members when deciding if and when to initiate a dispute against one of its trading partners at the WTO, its findings are inconsistent with those of competing theories that aim to explain why states enter into free trade agreements ('FTAs') in the first place.

As elaborated in the literature,<sup>33</sup> it is widely accepted that states conclude FTAs

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been the main argument in this debate. Many WTO members fear that there could be an abundant amount of *amicus curiae* briefs, which could constitute too serious a burden for panels and the Appellate Body and lead to a waste of resources. In addition to these traditional types of capacity constraints, the admission of *amicus curiae* briefs by powerful interest groups has been criticised as bringing about a new disequilibrium within the WTO dispute settlement mechanism. For detail on this last point, see Brigitte Stern, *L'intervention des tiers dans le contentieux de l'OMC*, 2 REVUE GÉNÉRALE DE DROIT INT'L PUB. 257, 294-5 (2003).

<sup>29</sup> See Sykes, *supra* note 7, at 17–29.

<sup>30</sup> *Id.* at 18. It should be added that this view of mutual trade 'concessions', though undoubtedly reflecting political reality, is clearly at odds with the fact that even unilateral trade liberalisation has beneficial effects. As recalled by Krugman, '[t]he economist's case for free trade is essentially a unilateral case: a country serves its own interests by pursuing free trade regardless of what other countries may do.' See further, Paul Krugman, *What should trade negotiators negotiate about?*, 35(1) J. ECON. LITERATURE 113 (1997).

<sup>31</sup> Sykes, *supra* note 7, at 24.

<sup>32</sup> Claus D. Zimmermann, *Rethinking the right to initiate WTO dispute settlement proceedings*, 45(5) J. WORLD TRADE 1057, 1062-6 (2011) [hereinafter Zimmermann].

<sup>33</sup> See, e.g., Judith L. Goldstein, Douglas Rivers & Michael Tomz, *Institutions in International Relations: Understanding the Effects of the GATT and the WTO on World Trade*, 61(1)

for essentially two reasons. *First*, they do so in order to facilitate government-to-government market access commitments.<sup>34</sup> According to this logic, the enforceable reciprocal commitments enshrined in FTAs serve to resolve the terms-of-trade prisoner's dilemma confronted by governments which have to conduct their own trade policy unilaterally.<sup>35</sup>

*Second*, FTAs serve as an important 'external commitment device' allowing governments to 'tie their hands' in order to better resist domestic lobbying from powerful, import-competing, industries. Giving in to such industries might maximise the government's short-term political welfare, but doing so would clearly be contrary to society's long-term interest in free trade.<sup>36</sup> Thus, FTAs enable governments to commit to voters in a credible manner that they will not give in to lobbying from private industries at the expense of the broader economy and the country's long-term interests. In the absence of such a commitment device, governments run an increased risk of being blamed by voters for future economic downturns, whether or not they are actually responsible for them.<sup>37</sup> By contrast, according to the logic underlying public choice theory, the maximisation of *joint* political welfare of government officials across the WTO's membership requires that governments ignore those treaty violations by other WTO members for which the political benefits arising from the treaty violation to the respondent is larger than the political cost to the officials of the complainant.<sup>38</sup> However, such behaviour would effectively 'untie the hands' of government officials when facing domestic interest groups since it clearly signals that, depending on the balance of

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INT'L ORG. 37 (2007); Krzysztof J. Pelc, *Eluding efficiency: why do we not see more efficient breach at the WTO?*, 9(4) WORLD TRADE REV. 629 (2010) [hereinafter Pelc].

<sup>34</sup> See generally, KYLE BAGWELL & ROBERT W. STAIGER, *THE ECONOMICS OF THE WORLD TRADING SYSTEM* (MIT Press 2002).

<sup>35</sup> Pelc, *supra* note 33, at 636. For detailed analysis, see Wolfgang Mayer, *Theoretical Considerations on Negotiated Tariff Adjustments*, 33(1) OXFORD ECON. PAPERS 135 (1981).

<sup>36</sup> See ROBERT E. HUDEC, *DEVELOPING COUNTRIES IN THE GATT LEGAL SYSTEM* (Gower Publishing, Trade Policy Research Centre 1987); Giovanni Maggi & Andrés Rodríguez-Clare, *The Value of Trade Agreements in the Presence of Political Pressures*, 106(3) J. POL. ECON. 574 (1988); Giovanni Maggi & Andrés Rodríguez-Clare, *A Political-Economy Theory of Trade Agreements*, 97(4) AM. ECON. REV. 1374 (2007); Eric Reinhardt, *Tying Hands without a Rope: Rational Domestic Response to International Institutional Constraints*, in *THE INTERACTION OF DOMESTIC AND INTERNATIONAL INSTITUTIONS* (Daniel W. Drezner ed., Univ. of Michigan Press 2001); Robert W. Staiger & Guido Tabellini, *Discretionary Trade Policy and Excessive Protection*, 77(5) AM. ECON. REV. 823 (1987); Robert W. Staiger & Guido Tabellini, *Do GATT Rules Help Governments Make Domestic Commitments?*, 11(2) ECON. & POL. 109 (1999). For a succinct discussion of the issue, see Pelc, *supra* note 33, at 636-9.

<sup>37</sup> Pelc, *supra* note 33, at 637. For detailed analysis, see Edward D. Mansfield & Eric Reinhardt, *International Institutions and the Volatility of International Trade*, 62(1) INT'L ORG. 621-52 (2008).

<sup>38</sup> See Schwartz and Sykes, *supra* note 9, at 180.

political costs and benefits to government officials across borders, lobbying for protectionism may be worthwhile.<sup>39</sup> Hence, the value of FTAs as credible external commitment devices for domestic politics would be crucially diminished.

In light of the above, capacity constraints and the desire of government officials to avoid formal litigation of politically sensitive issues may be the true reasons for why private persons have been denied standing in WTO dispute settlement and why governments have placed themselves in a position where they may effectively act as political filters *ex ante*.<sup>40</sup> Public choice theory, due to its narrow focus on the maximisation of political welfare, is not able to convincingly explain *why* governments reserved the role of political filters for themselves, since the very existence of this filtering power undermines the long-term benefits, from a domestic perspective, of entering into free or preferential trade agreements.

As analysed earlier,<sup>41</sup> the obligations under the WTO Agreement flow horizontally between WTO members and not vertically between the WTO as an institution and its members. However, this fact alone does not lead to the conclusion that the governments of WTO members necessarily have to be in a position where they can act as political filters *ex ante* of potential disputes. Similarly, from a purely legal perspective, the fact that the WTO Agreement as the underlying treaty framework creates legal rights and obligations exclusively for the parties to the treaty but not for private persons, may convincingly explain the intergovernmental nature of the WTO's dispute settlement mechanism. However, it does not explain why WTO disputes are not initiated centrally by the WTO Secretariat in order to avoid the situation where government officials of the WTO's membership may be tempted to renounce bringing certain disputes in order to maximise their joint political welfare, as posited by public choice theory.

As discussed elsewhere,<sup>42</sup> the WTO's dispute settlement mechanism could theoretically be reformed in a way that bestows the power to initiate formal dispute settlement proceedings upon a (yet to be created) public prosecution office in the WTO Secretariat. Such a reform would maintain the purely intergovernmental nature of WTO dispute settlement, thereby paying due regard to widespread concerns over capacity constraints. By taking away from individual WTO members their current capacity to conduct political filtering of potential disputes *ex ante*, such a reform would help to promote the objectives discussed above for which states enter into FTAs in the first place.

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<sup>39</sup> Pelc, *supra* note 33, at 639, relies on a very similar argument in explaining why and how allowing 'efficient breach' of the WTO agreements would empower those domestic players that are opposed to further trade liberalisation.

<sup>40</sup> Zimmermann, *supra* note 32.

<sup>41</sup> See Part III of this note, *supra*.

<sup>42</sup> Zimmermann, *supra* note 32.



For the purposes of the analysis provided by this note, *the reason why* the governments of WTO members have put themselves in a position where they may effectively interpose themselves as political filters when deciding whether or not to bring a dispute to the WTO is only of secondary importance. What ultimately matters for understanding why the WTO's dispute settlement mechanism lacks retrospective remedies is *the fact that* individual WTO members decide, at their exclusive discretion, *if, and if yes, when*, to submit an alleged breach of the WTO Agreement by another member to formal dispute settlement.

It is important to fully understand the consequences of the above state of affairs. Under the rules of the DSU, a WTO member which believes to have a viable legal claim against another member may decide that it is in its interest, for domestic or international reasons, to either not bring a case at all or to wait for a considerable amount of time – possibly several years – prior to initiating a formal dispute. Furthermore, one must take into account the increasing complexity of the WTO legal framework with its ever-growing body of jurisprudence, the various capacity constraints faced by the WTO's small and poor members as well as the increased likelihood of good-faith breaches arising from the underlying legal nature of WTO rules as international obligations of result as examined earlier in this note.<sup>43</sup> Under these circumstances, equipping the WTO's dispute settlement mechanism with retrospective remedies while leaving WTO members with full and exclusive discretion as to if, and if yes, when, to bring a case on alleged treaty violations, would run counter to basic ideas of fairness and would undermine the organisation's existing efforts to level the playing field between its developed and developing country members. Such a state of affairs would significantly increase the potential of good-faith breaches of the WTO Agreement, thereby decreasing the attractiveness of becoming a member of the WTO in the first place, as well as diminishing the willingness of WTO members to make increasingly ambitious concessions in future rounds of trade negotiations.

The following example illustrates the above argument. The government of WTO member 'X', due to its above-average expertise in the field of international trade, correctly finds that a new regulation adopted by WTO member 'Y' amounts to a breach of Y's WTO obligations owed to X. Y, a small developing country member that has only recently joined the WTO has adopted the regulation in good faith while its government officials are still struggling to develop the necessary expertise in matters of international trade. At this juncture, X decides not to bring a case immediately or to even raise the matter informally with Y as doing so would not be in line with its current government's political agenda. Following national elections three years later, X's new government eventually decides to initiate a dispute at the WTO against Y with regard to the aforementioned regulation whose

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<sup>43</sup> See Part III of this note, *supra*.

WTO-inconsistency X has been suspecting for several years. Under the current state of the DSU, if Y's contested measure was to be found inconsistent with its obligations under the WTO Agreement, the fact that X had let several years go by prior to raising the matter as part of a formal dispute would not lead to any additional burden for Y compared to a scenario where X had initiated a dispute immediately upon becoming aware of the potential WTO-inconsistency of Y's new regulation. To the extent that Y was to comply within the 'reasonable period of time' determined according to DSU Article 21.3, it would not have to provide X with any compensation, including for injury that had occurred over the years during which X had waited prior to submitting the matter to dispute settlement. By contrast, under a system equipped with retrospective remedies, the fact that X initiated a dispute after several years would make a big difference for Y. With WTO rules being international obligations of result, it would not help Y to argue that it maintained the contested matter in good faith. Y could therefore be found liable to provide compensation counting from the original date on which the contested measure entered into force.

## V. CONCLUSION

The focus of this note has been the neglected link between the underlying legal nature of WTO rules as international obligations of result (and not of conduct), the governmental filtering *ex ante* of WTO disputes, and the absence of retrospective WTO remedies. Both of these factors strongly support the view that the choice, by the drafters of the WTO Agreement, to renounce retrospective WTO remedies was an economically sensible one.

The two key findings of this note are the following. *First*, in addition to the increasing complexity of WTO law, it is the underlying nature of WTO rules as international obligations of result (and not of conduct) that makes this part of international economic law particularly prone to good-faith breaches. *Second*, in light of the fact that the governments of WTO members are in a position where they may interpose themselves as political filters of potential disputes, equipping such a system with *retrospective* remedies would significantly raise the cost of breach, thereby eroding the economic benefits of the system's current *prospective* design.

As recalled herein, the economic benefits of a dispute settlement mechanism which provides only prospective relief are the following. *First*, by lowering the cost not only of good-faith breaches of the WTO Agreement but of breaches in general, the prospective nature of WTO remedies creates an important incentive for WTO members to participate in future rounds of trade liberalisation. *Second*, the absence of retrospective remedies encourages WTO members to litigate disputes through to conclusion, thereby producing an important positive externality taking the form of valuable clarifications of the complex legal framework applicable to all WTO members, and not only to the parties to a given

dispute. *Third*, considering that the WTO's poor and small members are more likely to commit good-faith breaches, the absence of retrospective remedies is in line with the WTO's efforts to level the playing field between its members and to provide all of its members with equal opportunities in the context of dispute settlement.

In light of the analysis provided by this note, abandoning the current prospective nature of the WTO's dispute settlement mechanism and switching to retrospective remedies would be a coherent change only if it were accompanied by the following reforms of the WTO's dispute settlement mechanism.

*First*, in order to avoid the risk of good-faith breaches of the WTO Agreement being perceived as excessively costly, it would be essential to renounce the imposition of retrospective remedies wherever the respondent is able to demonstrate that it adopted the contested measure in good faith. However, it emerges from this note that requiring such proof would hardly make legal sense in light of the fact that WTO rules have been designed as international obligations of result and not of conduct.

*Second*, it would be important to find ways to avoid the scenario where, following the introduction of retrospective remedies, WTO members found to be in breach of their WTO obligations are required to provide compensation for past losses accumulated over several years due to the mere fact that the complainant member had arbitrarily decided not to bring a dispute immediately following the adoption of the contested measure. One solution to this dilemma could be to take away the right to initiate WTO disputes from individual WTO members and to transfer such power into the hands of a yet-to-be-created public prosecution office within the WTO Secretariat. Thus, centralised dispute initiation might provide WTO members with the necessary reassurance that the volume of compensation under a reformed system does not depend on the arbitrary whim of when the complainant member finds it opportune to bring a dispute. Alternatively, WTO members could be encouraged to promptly raise contested issues as part of WTO dispute settlement by a rule stipulating that claims against a given measure may only be brought within a relatively short period of time following its adoption.

Overall, abandoning the prospective nature of WTO dispute settlement would trigger the urgent need for additional fundamental reforms of the existing system. At present, it appears safe to say that both a shift to retrospective remedies, and all other potential reforms to the DSU addressed above, would fail to find significant support among the WTO's membership. Fortunately, it turns out that this is not necessarily bad news. The existing prospective nature of WTO dispute settlement has served the international trading system rather well. For the reasons discussed herein, switching to retrospective remedies may inflict greater harm than good.