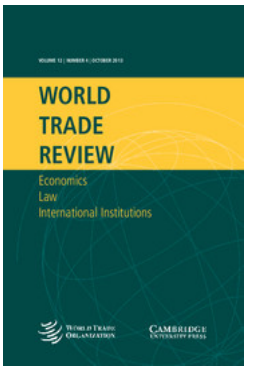

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Jurisprudential developments on the purpose of WTO suspension of obligations

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'If you don't know what you want, you end up with a lot you don't'.
Chuck Palahniuk, *Fight Club*

Abstract: This article examines World Trade Organization (WTO) jurisprudence on the question as to if the purpose of suspending concessions or other obligations is to induce compliance, to rebalance concessions, or both. WTO jurisprudence on this issue can be systematized into three steps. First, inducing compliance is the general purpose of suspension as complaining parties have the right to request the authorization to suspend concessions or other obligations as long as they meet the requirements spelled out in the WTO Dispute Settlement Understanding. The second step relates to the level of suspension. In general, WTO jurisprudence has accorded a higher hierarchy to the purpose of rebalancing concessions or other obligations, with some exceptions made regarding disputes on prohibited subsidies and diachronically variable suspension levels. As a third step, WTO jurisprudence has bestowed complaining Members freedom concerning the suspension's content, so as to induce the defending party to comply. Keeping these three steps in mind will hopefully make understanding WTO jurisprudence on suspension of concessions or other obligations easier.

1. Introduction

Article 22 of the World Trade Organization's (WTO) Dispute Settlement Understanding (DSU) allows, under certain circumstances, for WTO Members to suspend concessions or other obligations against another Member that has failed to bring a measure into compliance with a covered agreement. If the Member concerned objects to the level of suspension proposed or claims that the principles and procedures set forth in Article 22.3 DSU have not been followed, the matter shall be referred to arbitration according to Article 22.6 DSU.

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WTO Members as well as scholars disagree on what the aim of WTO suspension of concessions or other obligations is; moreover, it seems plausible that this issue may intentionally have been left ambiguous.[1] Therefore, this is arguably a case for the WTO's dispute settlement system 'to clarify the existing provisions of [the covered] agreements in accordance with customary rules of interpretation of public international law', according to Article 3.2 DSU.

The majority of arbitrators[2] in proceedings pursuant to Article 22.6 DSU[3] has discussed the purpose of suspending concessions or other obligations. Yet it appears to be unclear whether the purpose is to induce compliance or to rebalance concessions, or whether there is a hierarchy between these aims. For the suspension to induce compliance, its level should be higher than the (arguably both economic and political) benefits derived from the illegal action.[4] On the other hand, WTO law also supports the purpose of rebalancing concessions or other obligations, that is, to restore the level of concessions or other obligations between the parties to the dispute. Much depends on the answer. For instance, the level of suspended concessions or other obligations allowed may vary: Should the suspension level be higher, equal, or lower to the nullification or impairment suffered by the complaining party? Additionally, if the complaining Member cannot prove that nullification or impairment has been suffered, concessions or other obligations might be suspended only if the purpose of the suspension is to induce compliance.[5] To the contrary, if the aim is to rebalance concessions or other obligations, they should arguably not be suspended.

This article will analyze how WTO jurisprudence[6] has understood the purpose of suspending concessions or other obligations within the WTO system.

1 See Josling (2004: 341).

2 Some arbitrators have referred to themselves as 'arbitrator' while others have preferred 'arbitrators'.

3 In the context of this article, arbitrators, arbitrations, and arbitration decisions refer to those constituted, carried out and issued according to Article 22.6 DSU (except when otherwise noted).

4 'To be effective as a punishment, the sanctions must be above the benefits of not modifying the policy (or the costs of modifying it): the higher they are, the more likely they are to be effective' (Josling, 2004: 341).

5 If an arbitrator allowed the complaining Member to suspend a certain level of obligations in the absence of proof of nullification or impairment, the suspension would be what WTO arbitrators have understood as punitive (see Section 6 below).

6 The term 'jurisprudence' is not unusual in the context of WTO dispute settlement. WTO Members use it (for example WTO, 2009b: para. 87; WTO, 2011: para. 16), as well as panel reports (for example, WTO Panel Report, *European Communities – Measures Affecting the Approval and Marketing of Biotech Products*, WT/DS291/R, WT/DS292/R, WT/DS293/R, adopted 29 September 2006, para. 4.16; WTO Panel Report, *Thailand – Customs and Fiscal Measures on Cigarettes from the Philippines*, WT/DS371/R, adopted 15 November 2010, para. 4.104; WTO Panel Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/R, WT/DS169/R, adopted 31 July 2000, paras. 7.53 and 7.55). The AB seems to follow different approaches depending on the context. Its Annual Reports use the term rather frequently (for example, WTO, 2009a: Part IV.B; WTO, 2010: Part IV.A.1). When settling disputes, the Appellate Body Reports speak of 'jurisprudence' mainly when quoting the arguments of the parties or a panel report (regarding parties, see, for example, WTO Appellate Body Report, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain*, WT/DS276/AB/R, adopted 30 August

First, Section 2 will offer some brief words on teleological interpretation in the context of public international law. After that, Section 3 will take a look at the purpose of suspending concessions or other obligations from the public international law perspective, the history that led to WTO law, and WTO law itself. After briefly reviewing the only GATT dispute where a contracting party was authorized to suspend the application of concessions or other obligations (Section 4), this article will present, in chronological order, an overview of the argumentations that arbitrators pursuant to Article 22.6 DSU have offered on this subject (Sections 5 to 14), as well as other disputes where this issued has been discussed (Section 15). Section 16 offers a three-step approach to better understand WTO jurisprudence on the purpose of suspending concessions or other obligations. This article ends with some conclusions (Section 17).

A few words on terminology: In this article, the term 'suspension of concessions or other obligations' used in Article XXIII.2 GATT and Article 22 DSU will often be shorthanded as 'suspension of obligations' or simply 'suspension'. In general, in disputes regarding subsidies, arbitrators often mirror the wording used in the Agreement on Subsidies and Countervailing Measures (SCM Agreement), and, consequently, refer to 'countermeasures' instead of the 'suspension of concessions or other obligations'. Another expression sometimes used in the scientific literature on this subject is 'sanctions'.[7]

2. Teleological interpretation and WTO law

According to Article 31.1 of the Vienna Convention on the Law of Treaties (VCLT), '[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'. The International Law Commission expressed that

2004, para. 73; WTO Appellate Body Report, *United States – Final Dumping Determination on Softwood Lumber from Canada*, WT/DS264/AB/R, adopted 11 August 2004, para. 20; regarding panel reports, see, for example, WTO Appellate Body Report, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS246/AB/R, adopted 7 April 2004, para. 83; WTO Appellate Body Report, *China – Measures Affecting Imports of Automobile Parts*, WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R, adopted 15 December 2008, para. 128; WTO Appellate Body Report, *United States – Subsidies on Upland Cotton*, Recourse to Article 21.5 of the DSU by Brazil, WT/DS267/AB/RW, adopted 2 June 2008, paras. 196 and 226). Apart from that, to the best of my knowledge, the AB has used the term in only three dispute settlement reports (WTO Appellate Body Report, *United States – Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R, adopted 2 January 2002, para. 242; WTO Appellate Body Report, *United States – Continued Existence and Application of Zeroing Methodology*, WT/DS350/AB/R, adopted 4 February 2009, para. 198; WTO Appellate Body Report, *European Communities — Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/AB/R, adopted 18 May 2011, paras. 703 and 1122). In addition, the notion of 'GATT-jurisprudence' is not uncommon (for example, WTO Panel Report, *Korea — Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/R, WT/DS169/R, adopted 31 July 2000, paras. 7.53 and 7.55; WTO Appellate Body Report, *China–Auto Parts*, para. 128).

7 Charnovitz (2002a: 602–603).

the majority of jurists 'emphasizes the primacy of the text as the basis for the interpretation of a treaty, while at the same time giving a certain place to extrinsic evidence of the intentions of the parties and to the objects and purposes of the treaty as means of interpretation'.[8] Nevertheless, it underlined that there is no 'hierarchical order for the application of the various elements of interpretation in the article', but that 'the application of the means of interpretation in the article [is] a single combined operation'.[9]

The WTO Appellate Body (AB) has quoted Article 31 VCLT quite regularly, yet its interpretation of WTO law has often been somewhat literal[10] and, as a consequence, some authors have described it as rather formalistic and mechanical.[11] Moreover, the AB has frequently limited its teleological interpretation to the treaty as a whole, while excluding it for specific provisions.[12] Some authors think that the AB is paying 'lip service to the VCLT while ignoring its holistic and integrative approach to text, context and purpose'.[13] In short, the AB seems to have had some difficulty working with a teleological interpretation of WTO law.

3. The purpose of countermeasures and suspending obligations

The question about teleological interpretation also arises in the specific context of suspension of concessions or other obligations pursuant to Article 22 DSU. In fact, because quite a few elements in Article 22 DSU are pretty indeterminate, their open texture makes an examination of the aims of the rules all the more crucial.[14] Thus, it is important to ask what purpose suspension of WTO obligations has.

Some scholars have emphasized the importance of this teleological question and have tended to concentrate on a *de lege lata* analysis of WTO law[15] or on the WTO Members' perspective.[16] As a consequence, the jurisprudential argumentation has not been considered with the same depth.[17] This article, in contrast, will try to shed

8 International Law Commission (1966: 218, para. 2).

9 Ibid., pp. 219–220, paras. 8–9. See also WTO Panel Report, *United States — Sections 301–310 of the Trade Act 1974*, WT/152/R, paras. 7.21–7.22 as well as Lennard (2002: 22–24).

10 Irwin and Weiler (2008: 81, 89–95), Ortino (2006: 146–148), Davey (2005: 22). WTO Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 12. See also WTO Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, WT/DS4/AB/R, pp. 16–17, 20.

11 Ortino (2006: 122, 130–132).

12 Irwin and Weiler (2008: footnote 33).

13 Ibid., p. 94.

14 Hart (1961: 127–129).

15 For example, Ethier (2004: 451–453), Sacerdoti (2010: 25), Pauwelyn (2000: 343–344), Charnovitz (2001: 822–823), Lawrence (2003: 30–44), Spamann (2006: 41–45); and especially Pauwelyn (2010: 43–56) (who focuses on WTO law and jurisprudence). Regarding the GATT, see, for example, Brand (1993: 120–122).

16 For example, Shaffer and Ganin (2010: 82–85), and Ehring (2010: 244–246).

17 Authors who have analyzed the jurisprudential argumentation include, for example, Sebastian (2010: 123–126), and Renouf (2010: 137–140).

some light on how WTO jurisprudence has understood the purpose of suspending obligations.

This section starts with a look at the purpose of suspending obligations from the perspective of public international law. Next, it delves into the history that led to the WTO, specifically, the International Trade Organization's (ITO) Havana Charter and the General Agreement on Tariffs and Trade (GATT) because Article XVI.1 of the Agreement Establishing the World Trade Organization emphasizes that the WTO builds upon the GATT.[18] Lastly, this section concentrates on WTO law.

Tension exists regarding countermeasures in public international law between incentives and proportionality.[19] Article 49 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts adopted by the International Law Commission in 2001 (henceforward, quoted as Draft Articles) deals with the object and limits of countermeasures. It stresses in its first paragraph that countermeasures are intended to induce the state that is responsible for an internationally wrongful act to comply with its obligations. Paragraph 1 of the commentary to Article 49 states: 'Countermeasures are not intended as a form of punishment for wrongful conduct but as an instrument for achieving compliance with the obligations of the responsible State.' Paragraph 6 of the commentary to Article 49 adds: 'The test is always that of proportionality, and a State which has committed an internationally wrongful act does not thereby make itself the target for any form or combination of countermeasures irrespective of their severity or consequences.' In turn, Article 51 on proportionality explains: 'Countermeasures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and the rights in question.' Paragraph 7 of the commentary to that article states that 'a clearly disproportionate measure may well be judged not to have been necessary to induce the responsible State to comply with its obligations but to have had a punitive aim … In every case a countermeasure must be commensurate with the injury suffered.' In the *Air Services* arbitration, the Tribunal held that 'all countermeasures must, in the first instance, have some degree of equivalence with the alleged breach'; yet simultaneously it emphasized the importance of taking into account not only the injuries suffered but also 'the importance of the questions of principle arising from the alleged breach',[20] which arguably means permitting 'states to apply countermeasures that would be disproportionate in an economic sense, in order to enforce a principle'.[21] In addition, that same Tribunal held that the aim of countermeasures 'is to restore equality between the Parties and to

18 On WTO history, see, for example, Jackson (1997a: 31–78).

19 Mitchell (2006: 998–999).

20 *Air Service Agreement of 27 March 1946 between the United States of America and France*, United Nations Reports of International Arbitral Awards, vol. XVIII, 1978, para. 83, p. 443. See also paragraph 3 of the commentary to Article 51 of the Draft Articles.

21 Damrosch (1980: 792).

encourage them to continue negotiations with mutual desire to reach an acceptable solution'.[22] In other words, public international law aims at offering strong enough incentives while simultaneously ensuring that countermeasures remain proportional.[23]

Article 94.3 of the Havana Charter allowed countermeasures as follows: '[The] Executive Board … may … release the Member or Members affected … to the extent and upon such conditions as it considers appropriate and compensatory, having regard to the benefit which has been nullified or impaired.' Thus, countermeasures in the ITO were not to be allowed above the level of nullification or impairment.[24] In other words, they built upon reciprocity.[25]

Article XXIII.2 GATT refers to appropriateness regarding the authorization to suspend the application of concessions or other obligations. It should be noted that the GATT misses the compensatory element regarding countermeasures present in Article 94.3 of the Havana Charter.

GATT contracting parties examined the purpose of suspending obligations in 1954–1955 as they discussed an interpretative note to Article XXIII.2 GATT, and the Working Party expressed that the purpose of a complaint according to Article XXIII GATT was to ensure the withdrawal of the measures.[26] By 1988, the contracting parties stressed that countermeasures had a 'retaliatory purpose'[27] and the GATT Director General expressed that Article XXIII GATT 1947 did not require suspending equivalent obligations.[28] It seems then that the contracting parties and the Secretariat believed that GATT suspension of obligations was meant as incentives or, in other words, to induce compliance.

Regarding the dispute settlement system of the WTO, *de lege lata*, the ultimate purpose is to facilitate the settlement of individual disputes (according to Articles 3.2, 3.3, and 3.4 DSU) or, more broadly, to give a degree of efficacy to the primary obligations contained in the covered agreements.[29] Yet this does not define what those obligations are about.

On the one hand, the primary obligation for WTO Members may be to comply with each and every obligation as defined in WTO law, for example, not to raise tariffs above their bound duty rates. Accordingly, the purpose

22 *Air Service Agreement of 27 March 1946 between the United States of America and France*, United Nations Reports of International Arbitral Awards, vol. XVIII, 1978, para 90, p. 444.

23 Fukunaga (2006: 420).

24 Shadikhodjaev (2009: 56).

25 Barton *et al.* (2006: 40), Jackson (1967: 157–160).

26 GATT (1955: 19–20, para. 64). Incidentally, this paragraph seems to be the direct historical source for the fourth sentence in Article 3.7 DSU.

27 GATT (1988a: 36).

28 GATT (1988b: 19).

29 Vázquez and Jackson (2002: 562–563).

of suspension would be to induce compliance.[30] Inducing compliance means that incentives should be strong enough for the defending party to bring its measures back into compliance with the covered agreements.[31] Scholars and WTO jurisprudence have deduced that Articles 3.7 (fourth sentence), 3.2 (first and second sentence), 21.1 and 22.1 (second sentence) DSU, among others, speak on behalf of inducing compliance as the aim of suspending obligations.

On the other hand, the primary obligation for WTO Members may be to maintain a certain level of rights and obligations *vis-à-vis* other WTO Members. Accordingly, WTO Members might, for example, raise a tariff above the bound duty rate as long as it was compensated by correspondingly decreasing another tariff duty rate, thereby maintaining the overall level of concessions and obligations. In line with this primary obligation, the purpose of suspending certain concessions or obligations would be to rebalance the overall level of concessions and obligations between the Members concerned.[32] Rebalancing concessions or other obligations means that the level of concessions and obligations between the parties to the dispute should be restored. Arbitrators arguably understand this purpose as not to mathematically, but to notionally rebalance concessions and obligations, not least because they have sometimes admitted difficulties for calculating levels of nullification or impairment and levels of suspended concessions and obligations.[33] Articles 22.4 and 22.7 (first sentence) DSU are normally understood as the main normative background for this view. Somewhat related to this perspective, some authors have underlined that arbitration pursuant to Article 22.6 DSU is intended not to facilitate punishment, but to constrain it.[34]

In consequence, while WTO suspension of obligations certainly can serve other purposes, scholars and WTO jurisprudence have focused mainly on two aims: to induce compliance and rebalance obligations.

According to some authors, the historical origin of these two purposes for suspending obligations lies in differing European Communities (EC) and United States (US) perspectives during the late GATT years. The EC understood the

30 Pérez Aznar (2006: 52) stresses that in WTO law 'the concept of compliance has, on principle, a more limited meaning than in general international law'.

31 The question about how high the incentives should be in order to effectively induce compliance, is highly complex. The answer strongly depends on the particular circumstances of the case. For example, Drezner (1999: 27–55) built a game theory model regarding economic sanctions that includes variables such as opportunity costs of deadlock and expectations of future conflict between the parties.

32 Vázquez and Jackson (2002: 563).

33 See, for example, *Brazil – Export Financing Programme for Aircraft*, WT/DS46 (Article 22.6), footnote 58. On the complex task of rebalancing concessions, see, for example, Breuss (2004: 306–307), and Spamann (2006: 35–45).

34 Ethier (2004: 451–453); Sacerdoti (2010: 25).

GATT dispute settlement mainly as a continuation of political negotiations, while the US viewed it instead as a quasi-judicial system.[35]

The hierarchy between the purposes of WTO suspension of obligations does not seem to be a settled issue. WTO jurisprudence on this issue is difficult to systematize (see below). Most scholars seem to favor the inducing compliance perspective.[36] It seems that some WTO Members have changed their views over time.[37] Additionally, the WTO Secretariat has expressed that the suspension of obligations has the effect of rebalancing mutual trade benefits, and that complainants often suspend obligations with the intention of inducing compliance and '[a]ccordingly, the suspension can have the effect of inducing the respondent to achieve implementation'.[38] Besides being debatable as to how a mere intention of the complainant to induce compliance can cause the defendant to achieve implementation, the Secretariat's explanation may be interesting on a descriptive level, yet it offers no legal insight whatsoever.

The issue on the purpose of suspension has often crystallized on the issue of the level of suspended obligations. WTO law contains different benchmarks for defining the level of suspension of obligations and countermeasures, three of which have been applied so far in dispute settlements. Article 22.4 DSU states: 'The level of the suspension of concessions or other obligations authorized by the DSB [the WTO Dispute Settlement Body] shall be equivalent to the level of the nullification or impairment.' According to Articles 4.10 and 4.11 SCM Agreement, which are 'additional rules and procedures' according to Article 1.2 DSU, and, as such, are applicable to Article 22.6 DSU arbitrations, in disputes regarding prohibited subsidies, countermeasures shall be appropriate, while footnotes add that '[t]his expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited'. On actionable subsidies, Articles 7.9 and 7.10 SCM Agreement state that countermeasures shall be 'commensurate with the degree and nature of the adverse effects determined to exist'.

In other words, public international law and WTO law show a certain tension between incentives to comply and proportionality.

35 Brand (1993: 120–122). Van Bael (1988: 75), Parker (1989: 89) and Pescatore (1993: 6, 17–18) hold the same view.

36 Araki (2004: 346), Waincymer (2002: 663). Pro, for example, Pauwelyn (2000: 338–345), Charnovitz (2001: 797–808), Carmody (2002: 315–321), Charnovitz (2002a: 609–6615, 2002b: p. 421–426), McGivern (2002: 144–145), Waincymer (2002: 659–664), Sacerdoti (2010: 24), Mitchell (2006: 998–999). Contra, for example, Palmeter and Alexandrov (2002: 650–655), Lawrence (2003: 14–36, 43–44). Spamann (2006: 41–45), criticizes both perspectives. Some authors seem to think that WTO sanctions serve both purposes, apparently taking their compatibility somewhat for granted (for example, Fukunaga, 2006: 417).

37 Josling (2004: 341).

38 WTO (2004: 81).

The following sections refer to the only dispute where suspension of obligations was allowed during the GATT years and examine how WTO jurisprudence has understood and interpreted the purposes of WTO suspension of obligations.

4. Netherlands action under Article XXIII:2

In 1952, in the context of the *US Dairy Quotas* dispute, the Netherlands were authorized to suspend the application to the United States of certain obligations pursuant to Article XXIII GATT 1947. The Dutch arguments concentrated mostly on the violation of GATT norms, the Netherlands' economic context, and the damage this country was suffering because of US quantitative restrictions.[39]

The Working Party's Report focused mainly on the questions of 'whether, in the circumstances, the measure proposed was appropriate in character, and secondly, whether the extent of the quantitative restriction proposed by the Netherlands Government was reasonable, having regard to the impairment suffered'.[40] The topic of the purpose of the suspension was not discussed in the official texts. However, it seems plausible that some sort of what we now call 'rebalancing of obligations' might have been a relevant criterion as the report uses concepts such as 'reasonable' and 'equivalence' (and to a lesser extent, 'appropriate' and 'appropriateness') in a quantitative sense.[41] Moreover, the Working Party reduced the magnitude of the suspension the Netherlands had proposed because of 'information relating to the damage suffered by the Netherlands'.[42] The aforementioned reasonability between the quantitative restriction and the impairment was arguably understood as a quantitative correspondence between the damage suffered and the level of suspended obligations. The report did not emphasize offering strong incentives and there was arguably no need to do so as the United States itself had not denied the violation and wanted to remove it.[43] Because the authorization to suspend obligations was intended as a message to the US Congress, the need to restore the balance of obligations was probably stressed due to political considerations.[44] (However, and somewhat contradictorily, two days after the report was issued, the Chairman of the Working Party stated that the purpose for which the measure was taken was 'the removal of the United States restrictions'.)[45]

Compared to present WTO standards, this GATT decision is striking for its brevity and its relative lack of reasoning. WTO arbitrators pursuant to Article 22.6

39 GATT (1951a, 1951b, 1951c).

40 GATT Report adopted by the CONTRACTING PARTIES on 8 November 1952 (L/61), *Netherlands Action under Article XXIII:2 to Suspend Obligations to the United States*, para. 3.

41 Ibid., especially paras. 2, 3, and 6.

42 Ibid., Determination.

43 Hudec (1990: 182–184).

44 Ibid., p. 195.

45 GATT (1952: 1). See also Shadikhodjaev (2009: 58).

DSU have referred only twice to this GATT decision when discussing the purpose of suspending obligations in the WTO context.[46]

5. *EC–Bananas III* (Article 22.6 – US)

In 1999, in the Bananas III dispute,[47] the DSB authorized the US to suspend concessions or obligations to the EC equivalent to the level of nullification or impairment (Article 22.4 DSU). It was the first time that the suspension of obligations was allowed in the WTO system and one of the principal issues before the arbitrators pursuant to Article 22.6 was the purpose of suspending obligations. The arbitrators, while acknowledging that inducing compliance was an objective of WTO suspension of obligations, stressed that 'this purpose does not mean that the DSB should grant authorization to suspend concessions beyond what is *equivalent* to the level of nullification or impairment'.[48] Even if the complainant has suffered no nullification or impairment because no actual trade has been affected by the defendant (one might say, an ideal case for adopting the inducing compliance criterion), the arbitrators argued that the level of suspension is governed by rebalancing obligations, namely between suspended obligations and lost competitive opportunities.[49] As a consequence, punitive countermeasures (that is, suspension beyond the level of nullification or impairment) were not allowed.[50]

There are at least three ways to understand the arbitrators' standpoint. To start with, perhaps the arbitrators noticed but could not solve the contradiction between Articles 22.1 and 22.4 DSU. Thus, they may have made a reference to inducing compliance to maintain a façade of deference for Article 22.1 DSU while ultimately applying only the principle of rebalancing obligations.

Second, the arbitrators might have meant that suspending a level of obligations equivalent to the level of nullification does induce compliance.[51] Simply put, a suspension that rebalances obligations induces compliance. This would mean, though, that inducing compliance does not play any significant argumentative role, as rebalancing obligations would suffice for explaining the aim of suspending obligations and determining their level. Thus, this interpretation would suggest that the main purpose of suspending obligations is just to rebalance obligations.

46 *EC–Bananas III* (Article 22.6 – US), p. 6.4–6.5, *US–Prohibited Subsidies on Upland Cotton* (Article 22.6), p. 4.75–4.79, both cited below.

47 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), 9 April 1999; henceforth *EC–Bananas III* (Article 22.6 – US).

48 *EC–Bananas III* (Article 22.6 – US), para. 6.3.

49 *EC–Bananas III* (Article 22.6 – US), para. 6.11.

50 *EC–Bananas III* (Article 22.6 – US), paras. 4.1, 6.3.

51 *Brazil–Aircraft* (Article 22.6), footnote 49: 'the Article 22.6 arbitrators in the *EC–Bananas* case (referring to para. 6.3) considered that measures equivalent to the level of nullification or impairment can induce compliance'.

A third way to try to elucidate the arbitrators' interpretation could be the following: rebalancing obligations ensures that the level of suspended obligations *does not exceed* the level of nullification or impairment, while inducing compliance guarantees that suspended obligations *do not fall below* that level. That is, inducing compliance ensures that the level of suspension is not less than the maximal level set through recourse to the criterion of rebalancing obligations. Yet this view seems to run contrary to the ordinary meaning of rebalancing: Indeed, to rebalance can arguably be understood as restoring a balance, be this by either reducing the higher variable, increasing the lower variable, or both. Therefore, the criterion of rebalancing should suffice both to decrease an excessive level of suspension as well as to increase an insufficient level. In addition to the ordinary meaning, Article 22.4 DSU reinforces this interpretation: 'The level of the suspension of concessions or other obligations … shall be equivalent to the level of the nullification or impairment', that is, the level of suspension has to equal (thus, be *neither more nor less* than) the level of nullification or impairment. The criterion of inducing compliance would be irrelevant according to this interpretation, as the criterion of rebalancing obligations could explain any adjustment of the level of suspension, be it either a reduction or an increase.

In other words, the main problem with the arbitrators' reading on the purpose of suspending obligations is that in practice it arguably renders useless the criterion of inducing compliance as enshrined in Article 22.1 DSU. This, in turn, would arguably contradict the principle of *effet utile* that flows from Article 31 VCLT and has been developed and applied by the International Court of Justice (ICJ) and the AB.[52] This problem is especially acute since the arbitrators did not carefully weigh both principles but – without a thorough argumentation – adopted a perspective that favors rebalancing obligations at the expense of inducing compliance.

Interestingly, about one and a half years before this decision, the ICJ had referred to 'one … condition for the lawfulness of a countermeasure, namely that its purpose must be to induce the wrongdoing State to comply with its obligations

52 See, for example, the ICJ's *Corfu Channel* case (ICJ Rep., 1949, p. 24) and the Territorial Dispute Case (*Libyan Arab Jamahiriya* v. *Chad*) (ICJ Rep., 1994, p. 23). The AB has applied the principle of effectiveness almost since the WTO's inception; see *US–Gasoline*, p. 23. See also: *Japan – Alcoholic Beverages II*, p. 12–14; WTO Appellate Body Report, *United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear*, WT/DS24/AB/R, p. 16; WTO Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, para. 81; WTO Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, WT/DS113/AB/R, para. 135; WTO Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R, paras. 81 and 95; *US–Section 211 Appropriations Act*, para. 338; WTO Appellate Body Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/AB/R, WT/DS234/AB/R, para. 271. The panel in *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R, paras. 6.46, 6.49–6.53, derived this principle from good faith. See also Lennard (2002: 58–61).

under international law'.[53] Therefore, the arbitrators' position on inducing compliance is all the more intriguing.

To sum up, the arbitrators concentrated on guaranteeing that the level of suspended obligations did not exceed a level equivalent to the nullification or impairment. This reasoning relied mainly on an interpretation that stressed the importance of the equivalence requirement expressed in Article 22.4 DSU. In this decision, inducing compliance thus played practically no role regarding setting the level of the suspension of obligations. The arbitrators' argumentation is rather poor on why they adopted this interpretation, yet it has proven most influential for future arbitrations.

It is interesting to note that at least one author[54] has linked the arbitrators' views to the famous controversy that had taken place some years before between Judith H. Bello[55] and John H. Jackson[56] on whether compliance to WTO rules is voluntary. As a consequence, the arbitrators' position could perhaps be understood, in part, as an attempt not to take sides in that academic debate.

6. *EC–Hormones (US)* (Article 22.6) and *EC–Hormones (Canada)* (Article 22.6)

In 1999, the US and Canada requested authorization to suspend concessions or other obligations to the EC in *EC–Hormones (US)* (Article 22.6) and *EC–Hormones (Canada)* (Article 22.6), respectively.[57] The arbitrators pursuant to Article 22.6 DSU merely expressed their agreement with the aforementioned interpretation put forward in *EC–Bananas III* (Article 22.6 – US) on the purpose of suspending obligations in the WTO system.[58] Besides a quotation of *EC–Bananas III* (Article 22.6 – US),[59] they did not even mention inducing compliance as an aim of WTO suspension. On the contrary, the arbitrators referred somewhat often to their role as determining the equivalence between the level of nullification or impairment and the level of obligations suspended[60] (put differently, rebalancing

53 Gabčíkovo–Nagymaros Project (Hungary/Slovakia), Judgment, ICJ Reports 1997, para. 87.

54 Araki (2004: 346).

55 Bello (1996: 416–418).

56 Jackson (1997b: 60–64).

57 Decision by the Arbitrators, *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, Original Complaint by the United States, Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU (WT/DS26/ARB), 12 July 1999; and Decision by the Arbitrators, *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, Original Complaint by Canada, Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU (WT/DS48/ARB), 12 July 1999. Henceforth, these decisions are quoted as *EC–Hormones (US)* (Article 22.6) and *EC–Hormones (Canada)* (Article 22.6), respectively.

58 *EC–Hormones (US)* (Article 22.6), para. 40; *EC–Hormones (Canada)* (Article 22.6), para. 39.

59 *EC–Hormones (US)* (Article 22.6), para. 40; *EC–Hormones (Canada)* (Article 22.6), para. 39. Indirectly, inducing compliance is also mentioned in the quotation of Article 22.6 DSU at para. 2.

60 See, for example, *EC–Hormones (US)* (Article 22.6), para. 4; *EC–Hormones (Canada)* (Article 22.6), para. 4.

obligations). Symptomatically, even the discussion about so-called carousel sanctions – that is, suspension whose targeted obligations vary diachronically so as to maximize chilling effects – did not deal with their (arguably positive) effects on inducing compliance, but on how to ensure that such suspension was not punitive and hence rebalanced obligations.[61]

It is interesting to note that the arbitrators were apparently not overly enthusiastic about carousel sanctions as they interpreted the US' expression of intent regarding not implementing carousel sanctions as a unilateral promise.[62] In addition, some WTO Members opposed carousel sanctions.[63]

7. *EC–Bananas III* (Article 22.6 – Ecuador)

The next decision pursuant to Article 22.6 DSU was again issued in the Bananas III dispute,[64] but this time with Ecuador instead of the US requesting authorization to suspend concessions or other obligations to the EC. Because this arbitration dealt with the same subject matter and the same defendant as *EC–Bananas III* (Article 22.6 – US), the arbitrators wanted to ensure consistency between both decisions.[65] Therefore, this decision dealt rather superficially with many issues.

One topic the decision especially concentrated on had not been brought before the arbitrators in the previous Article 22.6 proceedings, namely the suspension of obligations according to Article 22.3 (b) to (g) of the DSU. It is regarding this so-called cross retaliation that the arbitrators laid out their interpretation of the purpose of suspending obligations. For cross retaliation to be authorized, Article 22.3 (b) and (c) of the DSU requires *inter alia* that so-called 'parallel retaliation' according to Article 22.3 (a) DSU be not effective and the arbitrators interpreted effectiveness as the suspension's ability to induce compliance: For a suspension to be effective, it has to empower 'the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance by the Member which fails to bring WTO-inconsistent measures into compliance with DSB rulings within a reasonable period of time'.[66] Interestingly, the arbitrators were able to reach this conclusion solely through an interpretation

61 *EC–Hormones (US)* (Article 22.6), paras. 22, 23. On carousel sanctions, see, for example, Wüger (2002: 804–812), and Ford (2002: 547–549, 565–569). On carousel sanctions and chilling effects, see, for example, WTO (2000: 1), and Kerr and Gaisford (2004: 169–176). Carousel sanctions had been discussed before in the *EC–Bananas III* dispute (see Komuro, 2000: 51–53).

62 *EC–Hormones (US)* (Article 22.6), para. 22.

63 See, for example, WTO (2002a: section II.D, 2002b, 2002c, lit. c, 2003a, lit. c, 2003b, section VI.C, 2003c: 6).

64 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), 24 March 2000; henceforth *EC–Bananas III* (Article 22.6 – Ecuador).

65 *EC–Bananas III* (Article 22.6 – Ecuador), para. 166.

66 *EC–Bananas III* (Article 22.6 – Ecuador), para. 72.

of effectiveness, that is, without a direct reference to Article 22.1 DSU. Only in a subsequent step did they observe that their interpretation was consistent with the object and purpose of the whole Article 22 (which they summarized as to induce compliance), and with the proper functioning of the WTO dispute settlement's enforcement mechanism.[67]

Yet the arbitrators also considered the requirements of Article 22.4 DSU. Thus, they stressed that the level of suspension should not be higher than the level of nullification or impairment suffered by the complainant and, as a consequence, allowed Ecuador to suspend a lower level of obligations than originally requested.[68] Therefore, inducing compliance did not allow for punitive countermeasures. In other words, the level of suspended obligations was determined by rebalancing obligations.

Additionally, the arbitrators posed the general question as to whether the suspension of obligations by small, import-dependent WTO Members against powerful Members can ever be effective and, hence, induce compliance.[69]

To sum up, the arbitrators recognized that one of the objectives of Article 22 DSU in general and of suspending obligations in particular is to induce compliance, and used this criterion to assist the examination of whether cross retaliation should be allowed. The level of suspended obligations was set through recourse to rebalancing obligations without regard to inducing compliance.

8. *Brazil–Aircraft* (Article 22.6)

The next arbitration decision on suspension of concessions or other obligations was *Brazil–Aircraft* (Article 22.6),[70] a dispute where Canada lodged a complaint against Brazil because of an export subsidy granted to foreign purchasers of Brazilian aircraft. The subsidy at issue was prohibited pursuant to the SCM Agreement. Hence, the suspension was ruled by Articles 4.10 and 4.11 SCM Agreement.[71]

The arbitrators had 'jurisdiction to determine whether the *level* or the *amount* of countermeasures proposed by Canada is appropriate' according to both Article 4.11 of the SCM Agreement and Article 22.7 of the DSU.[72] In turn, the arbitrators understood appropriateness as a more general criterion than equivalence between

67 *EC–Bananas III* (Article 22.6 – Ecuador), para. 76.

68 *EC–Bananas III* (Article 22.6 – Ecuador), paras. 1, 170, 171.

69 *EC–Bananas III* (Article 22.6 – Ecuador), para. 73.

70 Decision by the Arbitrators, *Brazil – Export Financing Programme for Aircraft*, Recourse to Arbitration by Brazil Under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement (WT/DS46/ARB), 28 August 2000; henceforth *Brazil–Aircraft* (Article 22.6).

71 *Brazil–Aircraft* (Article 22.6), para. 3.5.

72 *Brazil–Aircraft* (Article 22.6), para. 3.11.

the level of suspension of obligations and the level of nullification or impairment as expressed in Article 22.4 DSU.[73]

One of the main issues before the arbitrators was the question of 'whether the level of countermeasures should correspond to the amount of the subsidy to be withdrawn or be equivalent to the level of nullification or impairment caused to Canada'.[74] Therefore, the discussion revolved, to a great extent, around the meaning of the term 'appropriate'.

On the one hand, the arbitrators drew on the work of the International Law Commission (ILC) on state responsibility and reasoned that countermeasures are meant to induce compliance.[75] On the other hand, regarding the term 'appropriate', they first dismissed its ordinary meaning, and then without much argumentation, equaled it with 'effectiveness'. They concluded that countermeasures are appropriate if they effectively induce compliance.[76] Since the contested Brazilian measure had been found by the panel and the AB to be a prohibited export subsidy, it had to be withdrawn (Article 4.7 SCM Agreement) irrespective of whether it caused negative trade effects or not.[77] Accordingly, the arbitrators concluded that 'effectively "inducing compliance" means inducing the withdrawal of the prohibited subsidy'.[78] The arbitrators did not refer to rebalancing obligations as a purpose of countermeasures.

As already mentioned, prior arbitrators had stressed that punitive sanctions are not allowed according to Article 22.4 DSU. In this dispute, the arbitrators took a different stance and said that there does not necessarily have to be equivalence between the level of nullification or impairment and the level of the countermeasures. Both parties to the dispute agreed that appropriateness 'could be based on the amount of the subsidy'.[79] The arbitrators held that 'if the actual level of nullification or impairment is substantially lower than the subsidy', the level of the countermeasure may be higher than the level of nullification or impairment.[80] In other words, countermeasures might be analogous to what previous arbitrators had defined as punitive. Thus, the criterion of inducing compliance justified a level of countermeasures higher than necessary for rebalancing obligations. Therefore, the arbitrators understood that the upper limit for the level of countermeasures regarding prohibited subsidies is the greater of the following two variables: the level of nullification or impairment, or the amount of the subsidy. As a consequence,

73 *Brazil–Aircraft* (Article 22.6), footnotes 46 and 55.

74 *Brazil–Aircraft* (Article 22.6), para. 3.31; see also paras. 3.56–3.59.

75 *Brazil–Aircraft* (Article 22.6), para. 3.44.

76 *Brazil–Aircraft* (Article 22.6), paras. 3.43 and 3.44.

77 Put differently, there is an irrebuttable presumption that these subsidies cause negative trade effects. See *Brazil – Aircraft* (Article 22.6), paras. 3.46–3.49.

78 *Brazil–Aircraft* (Article 22.6), para. 3.45.

79 *Brazil–Aircraft* (Article 22.6), para. 3.27.

80 *Brazil–Aircraft* (Article 22.6), para. 3.54.

albeit without acknowledging it, the arbitrators to this dispute allowed punitive countermeasures on the grounds that they induce compliance.[81]

As expected, Brazil pointed out that countermeasures greater than the level of nullification or impairment would be punitive.[82] The arbitrators answered by taking a somewhat unexpected stance: Relying again on the work of the ILC, they redefined what a punitive countermeasure is, namely a countermeasure that 'not only [intends] to ensure that the State in breach of its obligations [brings] its conduct into conformity with its international obligations, but contains an additional dimension meant to sanction the action of that State'.[83] Somewhat surprisingly, the arbitrators did not give reasons for this change of interpretation. Except for a rather indirect reference to equivalence in footnote 55, they did not even mention that an arguably conflicting interpretation by previous arbitrators exists. Instead, it would probably have been sensible if they had, for example, re-examined and weighted the principles of rebalancing obligations and inducing compliance in the context of prohibited subsidies and examined both definitions of punitive countermeasures. Moreover, they did not answer whether these countermeasures would be punitive or not, but instead stated: 'Since we do not find a calculation of the appropriate countermeasures based on the amount of the subsidy granted to be disproportionate, we conclude that, *a fortiori*, it cannot be punitive.' This formulation is problematic for two main reasons.

First, the arbitrators had previously equaled the terms 'appropriate' and 'proportionate'.[84] Therefore, to say that 'appropriate countermeasures based on the amount of the subsidy granted [are not] disproportionate' is a tautology. A possible way to change the assertion so it makes sense would be: 'Since we do not find a calculation of the ~~appropriate~~ countermeasures based on the amount of the subsidy granted to be ~~disproportionate~~ not appropriate, we conclude that, *a fortiori*, it cannot be punitive.'

Second, even that reformulated sentence would not have been correct. As already explained, the arbitrators had defined appropriate countermeasures as those that effectively induce compliance.[85] In doing so, though, they had understood that the purpose of effectively inducing compliance requires a minimum level of countermeasures that had to at least be reached, arguably to even be surpassed. That is, countermeasures that exceed a certain value effectively induce compliance (hence, are appropriate) – and that can include punitive sanctions.[86] The arbitrators'

81 *Brazil–Aircraft* (Article 22.6), para. 3.54.

82 *Brazil–Aircraft* (Article 22.6), para. 3.55.

83 *Brazil–Aircraft* (Article 22.6), para. 3.55, quoting the Draft Articles (see above), p. 307.

84 *Brazil–Aircraft* (Article 22.6), footnote 51.

85 *Brazil–Aircraft* (Article 22.6), para. 3.44.

86 This assertion assumes that the benchmark of appropriateness will lie somewhere below the level of punitive countermeasures. It is, of course, also possible that certain levels of countermeasures are punitive but still are not great enough to effectively induce compliance (and, accordingly, are not appropriate.) Thus, the benchmark of appropriateness would start somewhere above the limit of punitive

logical error was to assume that countermeasures that meet the lower limit (e.g., those that effectively induce compliance, hence, are appropriate) cannot exceed the upper limit (e.g., being punitive, and this, according to this dispute's arbitrators and the ILC, are countermeasures that are meant to sanction the action of the state in breach of its obligations). To make the logical error more evident, one could paraphrase the arbitrators as follows: 'Since we do ~~not~~ find a calculation of the ~~appropriate~~ countermeasures based on the amount of the subsidy granted to ~~be disproportionate~~ effectively induce compliance, we conclude that, *a fortiori*, it cannot be punitive.'

A first practical consequence of this error is that the arbitrators did not present convincing arguments on why countermeasures greater than the level of nullification or impairment are not punitive. Thus, Brazil's claim was not satisfactorily answered. A second consequence is that the arbitrators missed the opportunity to define the 'additional dimension meant to sanction the action of the State that is in breach of its obligations' in the context of WTO countermeasures against prohibited subsidies. More generally, they did not explain why they relied on this concept for defining punitive sanctions. Third, they did not effectively offer arguments on if there is a level where countermeasures start to be punitive.

To sum up, this arbitration decision broke new ground as it was the first to deal with countermeasures against prohibited subsidies. According to the arbitrators, appropriate countermeasures have to effectively induce compliance, that is, induce the withdrawal of the prohibited subsidy. Consequently, the level of suspension of obligations may be higher than the level of nullification or impairment, and this amounts to what previous Article 22.6 DSU arbitrators understood as punitive. However, the decision left some important questions regarding punitive sanctions without a satisfying answer.

9. *US–FSC* (Article 22.6)

In *US–FSC* (Article 22.6)[87] the EC requested authorization to take appropriate countermeasures and to suspend concessions or other obligations against the US. This dispute involved prohibited subsidies.[88] For the arbitrators, a central argument was that the very existence of prohibited subsidies upsets the balance of rights and obligations between WTO Members, irrespective of the actual trade effects on the complainant.[89] Thus, prohibited subsidies have to be

countermeasures. Under these circumstances, all appropriate countermeasures would be punitive. Therefore, the arbitrators' assertion is not adequate for this scenario, either.

87 Decision by the Arbitrator, *United States – Tax Treatment for 'Foreign Sales Corporations'*, Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement (WT/DS108/ARB), 30 August 2002; henceforth *US–FSC* (Article 22.6).

88 *US–FSC* (Article 22.6), para. 2.6.

89 *US–FSC* (Article 22.6), paras. 5.23, 5.56, 6.7. See also Article 3.3 DSU.

withdrawn (Article 4.7 SCM Agreement).[90] Therefore, the arbitrators inferred that appropriate countermeasures are not limited to equivalence with the trade impact on the complaining Member.[91] This corresponds to what arbitrators pursuant to Article 22.6 DSU have, as a rule, understood as punitive sanctions. This conclusion is all the more evident after considering that the arbitrators used the concepts of trade effect and injury as synonymous, thereby talking about countermeasures being greater than the injurious effects.[92] In other words, the arbitrators in *EC–Bananas III (Article 22.6 – US)* had considered[93] that:

> level of suspension of obligations = level of nullification or impairment → equivalence
> level of suspension of obligations > level of nullification or impairment → punitiveness

or put differently, that regarding the level of suspension of obligations:

> equivalent < punitive

In contrast, the arbitrators in *US–FSC* (Article 22.6) (somewhat similarly to those in *Brazil–Aircraft* (Article 22.6)) cogitated[94] that regarding countermeasures:

> equivalent < appropriate < disproportionate = punitive

whereby equivalence (and, by extension, punitiveness) is defined in Article 22.4 DSU, appropriateness in Articles 4.10 and 4.11 of the SCM Agreement, and disproportionateness in footnotes 9 and 10 of the SCM Agreement. Moreover, it seems plausible that the arbitrators in *US–FSC* (Article 22.6) understood appropriateness as being equivalent to proportionate countermeasures.[95]

In this context, the arbitrators analyzed specifically the object and purpose of countermeasures according to Article 4.10 of the SCM Agreement and the WTO Agreement,[96] and came to the conclusion that they are to induce or 'secure compliance with the DSB's recommendation to withdraw the [prohibited] subsidy without delay'.[97]

Yet despite this statement that clearly highlights the importance of inducing compliance, the arbitrators ultimately seem to have followed a different line of reasoning. They probably wanted to underscore that they did not relinquish the notion of rebalancing as an aim of countermeasures (perhaps to avoid the

90 *US–FSC* (Article 22.6), paras. 5.22, 5.40. See also *Brazil–Aircraft* (Article 22.6), paras. 3.46–3.49.
91 *US–FSC* (Article 22.6), paras. 5.24, 5.30, 5.41, 5.49, 6.33, 6.34, 6.59.
92 *US–FSC* (Article 22.6), paras. 5.24, 5.41. In para. 5.24, the arbitrators also used the term 'injury.'
93 *EC–Bananas III* (Article 22.6 – US), paras. 4.1, 6.3.
94 *US–FSC* (Article 22.6), para 5.62.
95 *US–FSC* (Article 22.6), para 6.5.
96 *US–FSC* (Article 22.6), paras. 5.51–5.62. As in *Brazil–Aircraft* (Article 22.6) (see above), this arbitrators to this dispute relied also on the work of the ILC on State Responsibility.
97 *US–FSC* (Article 22.6), para. 5.52. The arbitrators seem to have understood 'to induce' and 'to secure' compliance as synonymous.

kind of claim relating to punitive sanctions that the arbitrators in *Brazil–Aircraft* (Article 22.6) had been confronted). Be that as it may, the arbitrators argued that because (as already mentioned) granting a prohibited subsidy upsets the balance of Members' rights and obligations, and because a panel can only recommend that a prohibited subsidy be withdrawn without delay (Article 4.7 SCM Agreement), the very act of withdrawing the prohibited subsidy restores the balance of rights and obligations.[98] In other words, inducing compliance means inducing the withdrawal of the prohibited subsidy which, in turn, means rebalancing obligations. Hence, one could argue either that both inducing compliance and rebalancing obligations are concomitant and mutually reinforcing purposes of countermeasures, or that as arguments, they are redundant and just one of them would suffice as an explanation of their purpose. Ultimately, the notion that withdrawing the prohibited subsidy restores the balance of rights and obligations can be understood as a reformulation of the already cited position held by the arbitrators in *EC–Bananas III* (Article 22.6 – US), namely that a suspension that rebalances obligations does induce compliance.[99]

It seems then that the *US–FSC* (Article 22.6) arbitrators (akin to the arbitrators in *EC–Bananas III* (Article 22.6 – US)) understood that rebalancing obligations is the main purpose of countermeasures. Since prohibited subsidies have to be withdrawn, the very existence of the subsidies is a nullification or impairment. Thus, to withdraw the subsidy means rebalancing obligations.

Yet, in contrast to *EC–Bananas III* (Article 22.6 – US), the arbitrators in *US–FSC* (Article 22.6) conceded that inducing compliance does play two (albeit somewhat subordinate) roles in disputes regarding prohibited subsidies. First, according to the arbitrators, the task of setting the level of appropriate countermeasures does not necessarily lead to exact results,[100] thus granting the arbitrators some leeway in determining the final level of obligations to be suspended. In disputes where arbitrators have such flexibility, the purpose of inducing compliance requires that arbitrators opt for the highest possible level of countermeasures within that range.[101] In other words, the rough appropriate level of obligations to be suspended is determined by rebalancing obligations, and the exact level, by inducing compliance. Second, inducing compliance might come into play when countermeasures are not allocated. According to the arbitrators, appropriate countermeasures in this dispute were determined by the amount of the prohibited subsidy. Had the subsidy affected multiple complainants, the level of countermeasures would most probably have had to be allocated across the multiple complainants. Since only the EC had requested permission to suspend obligations,

98 *US–FSC* (Article 22.6), paras. 5.42–5.43, 5.56.
99 *EC–Bananas III* (Article 22.6 – US), para. 6.3. See also *Brazil–Aircraft* (Article 22.6), footnote 49.
100 *US–FSC* (Article 22.6), paras. 5.10, 6.48, A34.
101 *US–FSC* (Article 22.6), paras. 6.55, 6.56.

was it entitled to act on behalf of other Members? The arbitrators denied this and said that if another complainant should obtain authorization to introduce countermeasures, the issue of allocation would have to be faced.[102] Yet the arbitrators allowed the EC to suspend obligations equivalent to the whole amount of the subsidy because it 'will have the practical effect of facilitating prompt compliance by the United States'.[103]

In sum, the arbitrators, on the one hand, concluded that rebalancing obligations is the purpose of WTO countermeasures regarding prohibited subsidies. On the other hand, they recognized that inducing compliance is relevant (at least in disputes regarding prohibited subsidies): first, for setting the level of obligations to be suspended when a margin of appreciation exists, and, second, when the level of countermeasures is not allocated between Members that suffered a nullification or impairment.

10. *Canada–Aircraft* (Article 22.6)

This dispute[104] concerned prohibited subsidies. The criterion of inducing compliance played a relevant role in the arbitration pursuant to Article 22.6 DSU as it is one of the factors that the arbitrators distilled from the arguments of Brazil and Canada (the complainant and the defendant, respectively) and that was helpful in evaluating the appropriateness of countermeasures.[105] The arbitrators even agreed that 'countermeasures are designed to induce compliance'.[106] Yet the question was whether the need to induce compliance should justify a level of countermeasures that was not appropriate in terms of Article 4.10 of the SCM Agreement.[107] The arbitrators concluded that it should not.[108] Their argumentation can be understood as being twofold.

First, they interpreted the requisite of the countermeasures' appropriateness as being hierarchically superior to the requirement of inducing compliance. This is a restatement of the arbitrators' position in *US–FSC* (Article 22.6),[109] namely that a level of countermeasures higher than appropriate should not be allowed because of disproportionateness (hence, punitiveness), according to Articles 4.10 and 4.11 of the SCM Agreement and their corresponding footnotes.

102 *US–FSC* (Article 22.6), paras. 6.26–6.30, 6.61–6.64.

103 *US–FSC* (Article 22.6), para. 6.29.

104 Decision by the Arbitrator, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Recourse to Arbitration by Canada under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement (WT/DS222/ARB), 17 February 2003; henceforth *Canada–Aircraft* (Article 22.6).

105 *Canada–Aircraft* (Article 22.6), paras. 3.31, 3.35, 3.38. The arbitrators were also concerned with the 'effectiveness of countermeasures in achieving compliance,' for example, in para. 3.25.

106 *Canada–Aircraft* (Article 22.6), para. 3.102.

107 *Canada–Aircraft* (Article 22.6), paras. 3.47, 3.48.

108 *Canada–Aircraft* (Article 22.6), para. 3.48.

109 *US–FSC* (Article 22.6), para 5.62.

Second, they reasoned that inducing compliance should not allow a level of countermeasures higher than appropriate, 'because of the uncertainty as to the level of countermeasures that would result in compliance'.[110] This argument is rather problematic. There is almost never a constellation where certainty exists *ex ante* as to the threshold where the level of countermeasures will result in compliance. In this respect, usually both of the parties to the dispute and the arbitrators rely not on certainties but on suppositions and expectations. Moreover, a Member could decide to suffer any level of suspension rather than to yield, as Canada arguably suggested in this dispute (see below). According to the arbitrators' view, inappropriate countermeasures would have been permissible if it had been known in advance that Canada intended to comply only if countermeasures reached a level considered as inappropriate according to Articles 4.10 and 4.11 of the SCM Agreement. This is clearly not a sensible assumption.

Additionally, the arbitrators stated that the uncertainty regarding the level of countermeasures that would result in compliance also exists because 'the nature of the countermeasures and the sectors subject to countermeasures have a role in determining likely compliance'.[111] The meaning of these words is somewhat unclear. Both elements (the nature of the countermeasures and the sectors subject to countermeasures) certainly do influence the probability of compliance. Perhaps the arbitrators wanted to underline that, according to Article 22.7 DSU, arbitrators 'shall not examine the nature of the concessions or other obligations to be suspended', so the Member seeking compliance has a great margin of freedom. As to the sectors subject to countermeasures, Members have leeway as long as they remain within the boundaries set by Article 22.3 DSU. However, there does not seem to be a robust argumentative nexus between the fact that those two elements have a role in determining likely compliance and the appropriate level of countermeasures.

The arbitrators referred again to inducing compliance when calculating the appropriate level of countermeasures. On the one hand, they consistently tried not to allow a level that they considered higher than appropriate. On the other hand, they apparently were conscious of the risk of setting a level too low to induce compliance. Therefore, they recalled that the standard of appropriateness enshrined in Article 4.10 of the SCM Agreement allowed them some flexibility, and, to that end, they considered various adjustments to the level of countermeasures.[112] During the arbitration, Canada had expressed that it would not withdraw the subsidy despite the DSB recommendations to do so.[113] Owing to that fact, the arbitrators underscored that 'countermeasures

110 *Canada–Aircraft* (Article 22.6), para. 3.48.
111 *Canada–Aircraft* (Article 22.6), para. 3.48.
112 *Canada–Aircraft* (Article 22.6), para. 3.63.
113 *Canada–Aircraft* (Article 22.6), paras. 3.106, 3.119.

are there to contribute to the end of a breach'[114] and, as a consequence, the level of countermeasures should be adjusted upwards. Because the arbitrators had previously decided what level was appropriate,[115] an additional upward adjustment means only one thing, namely countermeasures higher than appropriate, which in turn (according to *US–FSC* (Article 22.6)) means disproportionate and punitive. Although the arbitrators did not concede it, this was arguably the first time that inducing compliance played a decisive role in determining the level of suspension. The level of countermeasures was increased by 20%.[116] In this respect, it is interesting to note, first, that the arbitrators repeatedly emphasized the need to induce compliance.[117] Second, the latent possibility of imprecision (some might call it arbitrariness[118]) inherent in the Article 22.6 DSU arbitration system[119] became all too apparent as the arbitrators acknowledged that these adjustments cannot be precisely calibrated or calculated using a scientifically based formula. Hence, there is no apparent reason as to why the adjustment chosen had to be precisely 20%.[120]

To defend the arbitrators' position, one could argue that countermeasures are appropriate if their level remains within a certain margin. In that case, the arbitrators' decision could be understood as an upward movement within the margin. Thus, the countermeasures in this dispute would be appropriate even after the upward adjustment. Nevertheless, there are two main counterarguments. First, previous arbitrators had come to the conclusion that whenever a margin exists, the criterion of inducing compliance would require the arbitrators to choose the high end of the margin.[121] Therefore, the *Canada–Aircraft* (Article 22.6) arbitrators should have had to reach that upper limit in the first place and any subsequent upward adjustment would mean a level of countermeasures higher than appropriate. Second, it could be argued that the margin of imprecision ceases once the competent organ settles the dispute with a final judgment. In other words, once an arbitrator pursuant to Article 22.6 DSU sets the appropriate level of countermeasures, from a legal point of view there is no more imprecision regarding that appropriateness. Thus, since the arbitrators had set the appropriate level of

114 *Canada–Aircraft* (Article 22.6), para. 3.107. The arbitrators also said that 'the "appropriate" level of countermeasures should reflect the specific purpose of countermeasures', but did not clarify if they understood this specific purpose to be to induce compliance (see para. 3.47) or to ensure that prohibited subsidies are withdrawn (see para. 3.97 and Article 4.7 SCM Agreement).

115 *Canada–Aircraft* (Article 22.6), para. 3.90.

116 *Canada–Aircraft* (Article 22.6), para. 3.121.

117 *Canada–Aircraft* (Article 22.6), paras. 3.119–3.122.

118 Lawrence (2003: 58). See also Mitchell (2006: 1003–1004). Contra: Sebastian (2010: 126).

119 For example, the arbitrators in *Brazil–Aircraft* (Article 22.6), footnote 58, and in *US–FSC* (Article 22.6), paras. 5.10, 6.48, 6.49, A.34 acknowledged that counterfactuals are based on assumptions.

120 *Canada–Aircraft* (Article 22.6), para. 3.122.

121 *US–FSC* (Article 22.6), paras. 6.55, 6.56.

countermeasures for this dispute, the subsequent upward adjustment did mean a level higher than appropriate.

In summary, the arbitrators in *Canada–Aircraft* (Article 22.6) first underscored that the appropriateness of countermeasures is more important than inducing compliance. Yet when faced with a responding party that openly defied the WTO dispute settlement system, they allowed a level of countermeasures higher than appropriate but did so without explicitly revising their original stance. Thus, they arguably contradicted themselves. Regarding the topic of the purpose of suspending obligations, the importance of this arbitration decision resides in the acknowledgement that inducing compliance is a relevant criterion for setting an appropriate level of countermeasures.

11. *US–1916 Act* (Article 22.6)

In *US–1916 Act* (Article 22.6),[122] the EC requested authorization to suspend concessions or other obligations to the US. The level of suspension was set according to the standard defined in Article 22.4 DSU, which the arbitrators summarized as having to be 'equivalent to the level of nullification or impairment sustained by the complaining party as a result of the failure of the responding party to bring its WTO-inconsistent measures into compliance'.[123]

The arbitrators briefly discussed the purpose of suspending obligations and they expressed that they were 'not called upon to "provide a comprehensive list of the purposes" of the suspension of concessions or other obligations, or to "rank these purposes in some sort of order of priority." '[124] Nevertheless, they said that 'a key objective of the suspension of concessions or obligations – whatever other purposes may exist – is to seek to induce compliance by the other WTO Member with its WTO obligations'.[125]

Additionally, the EC proposed not a quantitative but a qualitative interpretation of the notion of 'level' expressed in Article 22.4, as it would be 'fully consistent with the objective and purpose of retaliatory measures, namely to induce compliance with the WTO obligations by the other Member'.[126] Despite the arbitrators' ultimate endorsement of this interpretation, they did not draw any conclusions as to the purpose of countermeasures.

The arbitrators were far more concerned with the notion of equivalence than with the purpose of suspending obligations. They stressed 'the critically important

122 Decision by the Arbitrators, *United States – Anti-Dumping Act of 1916*, Recourse to Arbitration by the United States under Article 22.6 of the DSU (WT/DS136/ARB), 24 February 2004; henceforth *US–1916 Act* (Article 22.6).

123 *US–1916 Act* (Article 22.6), para. 4.5.

124 *US–1916 Act* (Article 22.6), para. 5.4.

125 *US–1916 Act* (Article 22.6), para. 5.5.

126 *US–1916 Act* (Article 22.6), para. 5.12.

point that the concept of "equivalence", as embodied in Article 22.4, means that obligations cannot be suspended in a punitive manner'.[127] In other words, the arbitrators followed previous arbitration decisions and, apparently, considered that inducing compliance would not justify a level of countermeasures beyond equivalence.

In short, the arbitrators stressed the importance of inducing compliance and simultaneously allowed a level of suspended obligations that corresponds to the purpose of rebalancing obligations.

12. *US–Offset Act (Byrd Amendment)* (Article 22.6)

In *US–Offset Act (Byrd Amendment)*,[128] the level of suspension of concessions or other obligations had to be equivalent to the level of nullification or impairment according to Article 22.4 DSU.[129]

The arbitration award pursuant to Article 22.6 DSU dealt with the purpose of the suspension. One complaining party raised the issue of the relationship between inducing compliance and rebalancing obligations and said that 'while the suspension of concessions or other obligations is intended to induce compliance, it is compliance alone that maintains the proper balance of rights and obligations affected by the measure found to be inconsistent'.[130]

Contrarily, the arbitrators were quite frank in recognizing a lack of clarity regarding the object and purpose of suspending obligations and that this situation affected the arbitration proceeding.[131] They explicitly drew attention to the tension between inducing compliance and the requirement of equivalence between the level of nullification or impairment and the level of the suspension of obligations.[132] Moreover, the arbitrators underscored that:

> Having regard to Articles 3.7 and 22.1 and 22.2 of the DSU as part of the context of Articles 22.4 and 22.7, we cannot exclude that inducing compliance is part of the objectives behind suspension of concessions or other obligations, but at most

127 *US–1916 Act* (Article 22.6), para. 5.8. See also for example para. 7.11.

128 Decision by the Arbitrator, *United States – Continued Dumping and Subsidy Offset Act of 2000*, Recourse to Arbitration by the United States under Article 22.6 of the DSU, 31 August 2004. Parallel complaints were filed, leading to the following eight Article 22.6 DSU arbitration decisions: Brazil (WT/DS217/ARB/BRA), Canada (WT/DS234/ARB/CAN), Chile (WT/DS217/ARB/CHL), the European Communities (WT/DS217/ARB/EEC), India (WT/DS217/ARB/IND), Japan (WT/DS217/ARB/JPN), Korea (WT/DS217/ARB/KOR), Mexico (WT/DS234/ARB/MEX). As these decisions' content is quite similar, for this article's purpose, they will be considered as a conceptual unity. For simplicity's sake, as a rule, quotations will refer to the EEC decision (see Tijmes, 2013: section 4 and annex H). Henceforth, these decisions are quoted as *US–Offset Act (Byrd Amendment)* (Article 22.6), with the name of the respective complaining Member added to the final parenthesis.

129 *US–Offset Act (Byrd Amendment)* (Article 22.6 – EEC), para. 3.48.

130 *US–Offset Act (Byrd Amendment)* (Article 22.6 – Chile), para. 3.7.

131 *US–Offset Act (Byrd Amendment)* (Article 22.6 – EEC), para. 6.4.

132 *US–Offset Act (Byrd Amendment)* (Article 22.6 – EEC), paras. 6.2–6.3.

> it can be only one of a number of purposes in authorizing the suspension of concessions or other obligations. By relying on 'inducing compliance' as the benchmark for the selection of the most appropriate approach we also run the risk of losing sight of the requirement of Article 22.4 that the level of suspension be *equivalent* to the level of nullification or impairment.[133]

In this dispute, a piece of US legislation was deemed WTO-inconsistent as such, not as applied, and the complaining parties requested a diachronically variable level of suspension[134] (that is, a suspension level that automatically adapts to changes in the level of nullification or impairment). For two main reasons, the arbitrators concluded that diachronically variable suspension would have positive effects, especially in inducing compliance. First, there would be an obvious incentive for the US to reduce the WTO-illegal disbursements, that is, to comply. Second, a variable level of suspension would mean an incentive for not increasing the level of the nullification or impairment, which is also a form of inducing compliance. The arbitrators emphasized that diachronically variable suspension could help achieving the objective of inducing compliance 'without affecting the requirement of "equivalence" between the level of nullification or impairment and the level of suspension under Article 22.4 of the DSU'.[135]

To summarize, in this dispute the criterion of inducing compliance was a relevant factor for the arbitrators as they allowed a diachronically variable level of suspension. Except for that, the arbitrators did not even try to answer the question of what the objective of WTO suspension is. On the contrary, they acknowledged the lack of clarity, which, in this respect, exists in WTO law.

13. *US–Gambling* (Article 22.6)

In this dispute between Antigua and Barbuda as the complainant and the US as the defendant,[136] the level of suspension was set according to the standard of Article 22.4 DSU. The arbitrators pursuant to Article 22.6 DSU tried to shed some light on the question as to if the purpose of suspending concessions or other obligations is to induce compliance or to rebalance obligations. They stated that:

> while the purpose of suspension of concessions or other obligations under the covered agreements as foreseen in Article 22.1 of the DSU is to 'induce compliance' by the Member concerned with its obligations under the covered agreements, this does not mean that such suspension may be authorized beyond

133 *US–Offset Act (Byrd Amendment)* (Article 22.6 – EEC), para. 3.74.

134 *US–Offset Act (Byrd Amendment)* (Article 22.6 – EEC), para. 4.19; *US–Offset Act (Byrd Amendment)* (Article 22.6 – Chile), paras. 4.15–4.19.

135 *US–Offset Act (Byrd Amendment)* (Article 22.6 – EEC), para. 4.25.

136 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), 21 December 2007; henceforth *US–Gambling* (Article 22.6).

> what is 'equivalent' to the level of nullification of impairment. Rather, in setting out the requirement that suspension be 'equivalent' to the level of nullification or impairment, Article 22.4 of the DSU requires a degree of 'correspondence or identity' between the level of the suspension to be authorized and the level of the nullification or impairment of benefits.[137]

The arbitrators reformulated the position held by the arbitrators in *EC–Bananas III* (Article 22.6 – US) and held that regarding the level of suspension the aim is to rebalance obligations. Hence, the level of obligations the complaining party may suspend should be equivalent, thus neither above nor below the level of nullification or impairment it suffered[138] and the complaining party is entitled to seek equivalence.[139] In other words, the purpose of rebalancing obligations can justify increasing a low level of suspension until it is equivalent to the level of nullification. Consequently, if the criterion of inducing compliance plays any role at all, it seems to be only rhetorical. This conclusion is supported by an analysis of the arbitrators' expressions, as they consistently conveyed that they understood that their mandate was to ensure equivalence between the level of suspension and the level of nullification or impairment according to Articles 22.4 and 22.7 DSU.[140] In fact, inducing compliance was discussed at some length and found to be relevant only twice.

First, one arbitrator issued a dissenting opinion[141] and found that the criterion of inducing compliance might play a role for choosing the counterfactual[142] (a similar interpretation to the one offered by the arbitrators in *US–FSC* (Article 22.6)). The underlying assumption is that counterfactuals are imprecise[143] and this imprecision gives the arbitrators, as the dissenting arbitrator put it, some leeway within the limits of reasonability.[144] In other words, as there is no way of knowing what the level of nullification or impairment really is, there is also no way of knowing how to exactly rebalance obligations. Thus, as long as one cannot reasonably say that the threshold of punitive sanctions has been reached, the level of suspension should be as high as possible and, thereby, induce compliance. To put it simply, the relevance of inducing compliance as a criterion for setting the level of suspension derives from the impossibility of calculating the exact level of nullification or impairment. Should a method for doing this be devised someday, the criterion of inducing compliance might arguably become useless.

137 *US–Gambling* (Article 22.6), para. 2.7 (footnotes omitted).

138 *US–Gambling* (Article 22.6), para. 3.24.

139 *US–Gambling* (Article 22.6), para. 3.27.

140 See, for example, *US–Gambling* (Article 22.6), paras. 2.9, 3.11, 3.24, 3.27, 3.144, 5.10.

141 This was the first time a dissenting opinion was issued in an Article 22.6 DSU arbitral decision. While dissent can weaken collegiality, cohesiveness and legitimacy, it can be valuable for improving decisions as long as it is exercised sparingly (Lewis, 2006: 916–919; see also Cavalier, 1999: 134).

142 *US–Gambling* (Article 22.6), para. 3.70.

143 *US–Gambling* (Article 22.6), para. 3.26.

144 *US–Gambling* (Article 22.6), para. 3.70. See also para. 3.27.

Inducing compliance would be not so much a purpose of suspension, but a makeshift arrangement for coping with inexact econometrics. It is debatable whether that is a reasonable interpretation of Article 22.1 DSU. Moreover, this interpretation does not seem to be compatible with the way previous arbitrators have understood Article 21.1 DSU, namely that 'the purpose of suspension of concessions or other obligations under the covered agreements as foreseen in Article 22.1 of the DSU is to "induce compliance" by the Member concerned with its obligations under the covered agreements'.[145]

Second, the role of inducing compliance was examined at some length while discussing so-called parallel and cross retaliation according to Article 22.3 DSU. As a first step, the arbitrators considered the suspension of obligations according to Article 22.3 (a) and (b) DSU. They confirmed the interpretation laid out by the arbitrators in *EC–Bananas III* (Article 22.6 – Ecuador) that, according to Article 22.3 (b) and (c) of the DSU, suspension is effective if it induces compliance.[146] In this respect, the arbitrators observed that Antigua and Barbuda most probably did not import any services from the US that fell under the sector in which a violation was found in this dispute.[147] Thus, the arbitrators concluded that suspending obligations under that sector would not be effective.[148] In other words, a suspension that does not affect actual trade is not effective; hence, it cannot induce compliance. The arbitrators could have decided that also the effects on hypothetical trade flows should be considered. Since previous arbitration decisions had not recognized reductions in hypothetical trade flows (the so-called 'chilling effect' or 'deterrent effect') for calculating the level of nullification or impairment,[149] it is coherent that the arbitrators to this dispute decided that hypothetical trade flows should also not be considered when discussing the level of suspension.

As a second step, the arbitrators discussed cross retaliation according to Article 22.3 (c) DSU and, again, one of the issues was the effectiveness of the suspension of obligations, that is, inducing compliance.[150] The arbitrators held that the adverse impact of suspension on the complainant and the defendant are the two elements that define effectiveness in this context.[151] That inducing compliance depends, to a great extent, on the effects of suspended obligations on the defendant should be

145 *US–Gambling* (Article 22.6), para. 2.7.

146 *US–Gambling* (Article 22.6), para. 4.29; *EC–Bananas III* (Article 22.6 – Ecuador), para. 72.

147 *US–Gambling* (Article 22.6), paras. 4.43, 4.55, 4.59.

148 *US–Gambling* (Article 22.6), paras. 4.56, 4.60. The arbitrators simultaneously analyzed practicability and effectiveness according to Article 22.3 (b) and (c) DSU.

149 *US–1916 Act* (Article 22.6), paras. 5.64–5.72. Interestingly, the Netherlands had (without using the term) referred to the chilling effect in the context of the Netherlands Action under Article XXIII:2: see GATT/CP.6/26, 19 September 1951, page 2, and Press Release GATT/41, 24 September 1951.

150 The arbitrators simultaneously discussed the sanction's practicability and if circumstances were serious enough.

151 See especially *US–Gambling* (Article 22.6), paras. 4.89, 4.91, 4.92, 4.97. In para. 4.89, the arbitrator almost paraphrased *EC–Bananas III* (Article 22.6 – Ecuador), para. 73.

obvious. More problematic is the linkage of effectiveness (and, hence, inducing compliance) with the effects of suspension on the complainant. The fact that suspension does affect the complainant is not seriously contested, as previous arbitrators as well as scholars have recognized.[152] However, it is debatable if it affects the effectiveness of suspension. More likely, this variable affects the practicability referred to in Article 22.3 (b) and (c) DSU – practicability, in this context, is understood as meaning whether a suspension 'is available for application in practice, as well as suited for being used in a particular case'.[153] Since the arbitrators were simultaneously dealing with effectiveness and practicability, two of the requisites spelled out in Article 23.3 (c) DSU, the question arises as to whether the arbitrators were in fact thinking that the effects of suspension on the complainant affect not effectiveness but practicability.[154] However, there are two counterarguments. First, in this context, the arbitrators did not confine their argumentation to practicability but regularly referred to that criterion in conjunction with effectiveness.[155] In fact, the arbitrators mentioned only effectiveness and omitted practicability at least once.[156] Second, the arbitrators quoted a previous arbitration decision that linked the harm suffered by the complaining party only to effectiveness.[157] To sum up, apparently the arbitrators confused the variables that affect the effectiveness of suspension, that is, their ability to induce compliance.

In a nutshell, the arbitrators to this dispute understood the purpose of WTO suspension in practice to be to rebalance obligations. First, though, a dissenting opinion recognized that inducing compliance is relevant for choosing between imprecise counterfactuals. Second, the arbitrators linked inducing compliance to the suspension of obligations while analyzing cross retaliation. This, in part, seems to rest on a confusion of effectiveness and practicability.

152 See, for example, *EC–Bananas III* (Article 22.6 – Ecuador), para. 72; Breuss (2004: 275–315). See also Pauwelyn (2000: 338); Charnovitz (2001: 814–817); de Bièvre (2002: 1010–1011).

153 *US–Gambling* (Article 22.6), para. 4.29, quoting *EC–Bananas III (Ecuador)*, para. 70.

154 The arbitrators offered an interpretation of practicability in *US–Gambling* (Article 22.6), paras. 4.29 and 4.84. In para. 4.103, the arbitrators linked the consequences of countermeasures on the complainant to the 'broader economic elements' that have to be taken into account according to Article 22.3 (d)(ii) DSU, and in para. 4.113 they linked them to the seriousness of circumstances referred to in Article 22.3 (c) DSU.

155 As an exception, the arbitrators referred to 'practicability and feasibility' in *US–Gambling* (Article 22.6), para. 4.77. Additionally, Antigua and Barbuda was quoted as discussing the practicability of replacing service providers (para. 4.94).

156 *US–Gambling* (Article 22.6), para. 4.89, second sentence. See also, for example, para. 4.114, first sentence.

157 *US–Gambling* (Article 22.6), para. 4.90, referring to *EC–Bananas III* (Article 22.6 – Ecuador), para. 73.

14. *US–Upland Cotton* (Article 22.6)

The arbitrators issued two decisions pursuant to Article 22.6 DSU in *US–Upland Cotton*, one concerning prohibited subsidies, the other about actionable subsidies.[158]

Regarding prohibited subsidies, Brazil (the complaining party) requested two sets of countermeasures according to Articles 4.10 and 4.11 of the SCM Agreement: first, a one-time countermeasure in relation to a disbursement the US (the responding party) had made in a certain year, and, second, diachronically variable countermeasures proportionate to the amount of an on-going subsidy.[159]

First, Brazil requested the one-time countermeasure because the US had not withdrawn a subsidy until 31 July 2006, despite that the period to comply, set according to Article 21.3 (c) DSU, had ended on 1 July 2005. Thus, Brazil was seeking countermeasures in relation to past non-compliance. It was not seeking retroactive countermeasures, as the period of time to comply had already ended.[160] (The subsidy was withdrawn before the compliance panel according to Article 21.5 DSU was requested on 18 August 2006 and there was no determination in the compliance proceedings that the US had failed to comply in relation to this measure.) The arbitrators pursuant to Article 22.6 DSU concluded that, in this respect, there was no legal basis for Brazil to seek countermeasures.[161]

Regarding the purpose of countermeasures, the arbitrators were right in pointing out that inducing compliance made no sense regarding measures that had already been implemented.[162] However, they failed to adequately consider the systemic implications. According to the arbitrators' reasoning, the respondent will not face countermeasures as long as he complies before the panel pursuant to Article 21.3 (c) DSU is established or possibly even before the arbitrator according to Article 22.6 DSU is composed. This interpretation, in fact, extends the period to comply,[163] thereby reducing the incentives to implement the recommendations and

158 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), 31 August 2009; henceforth *United States – Prohibited Subsidies on Upland Cotton* (Article 22.6). 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 7.10 of the SCM Agreement (WT/DS267/ARB/2), 31 August 2009; henceforth *United States – Actionable Subsidies on Upland Cotton* (Article 22.6). References to both decisions will be quoted as *US–Upland Cotton* (Article 22.6).

159 *US–Upland Cotton* (Article 22.6), paras. 2.5–2.6.

160 On retroactive suspension of concessions, see, for example, Horlick (1995: 168–169, 171), Vázquez and Jackson (2002: 558–562), Mercurio (2004: 843–844), Krmpotic (2002: 668–682), Yenkong (2005), Goh and Ziegler (2003).

161 *United States – Prohibited Subsidies on Upland Cotton* (Article 22.6), paras. 3.1–3.64.

162 *United States – Prohibited Subsidies on Upland Cotton* (Article 22.6), paras. 3.43–3.50.

163 If a responding party implements the recommendations and rulings of the DSB after the expiry of the period of time to comply, yet the arbitrators pursuant to Article 22.6 DSU do not grant authorization to suspend concessions, they are in fact extending the period to comply. This contravenes Article 21.3 DSU as that norm strictly defines who shall determine the period to comply. Thus, in the present dispute, the

rulings of the DSB on time, namely before the period to comply set according to Article 21.3 DSU expires. This conflicts with one of the main purposes of the DSU: ensuring prompt compliance with recommendations or rulings of the DSB (Article 21.1 DSU).

Both inducing compliance and rebalancing obligations made no sense as the purpose of one-time countermeasures. Actually, Brazil's request makes more sense as an attempt at full reparation for the material damage caused by the wrongful act (Article 31 of the Draft Articles). However, WTO jurisprudence has ruled out interpreting the suspension of obligations as a means for reparation.[164]

Second, Brazil also requested diachronically variable countermeasures proportionate to the amount of an on-going subsidy. As regards the purpose of suspending obligations, the arbitrators linked the trade-distorting impact of the prohibited subsidy at issue with 'the extent to which the balance of rights and obligations between the parties has been upset by the granting and maintenance of the prohibited subsidy at issue'.[165] The arbitrators understood that the countermeasures should 'ensure a relationship of proportionality' between trade opportunities affected by the subsidy and trade opportunities affected by the countermeasure, and would, therefore, 'notionally restore the balance of rights and obligations' between the parties.[166] They expressed that inducing compliance appeared 'to be the common purpose of retaliation measures in the WTO dispute settlement system, including in the context of Article 22.4 of the DSU', but this criterion did 'not in and of itself provide specific indications as to the *level* of countermeasures that may be permissible'.[167] Moreover, the arbitrators concluded that countermeasures against prohibited subsidies required a demonstration of adverse effects even though that made them less powerful for the purpose of inducing compliance.[168]

As regards actionable subsidies and the purpose of countermeasures, the arbitrators held the same view as in the decision about prohibited subsidies, namely that the purpose was to induce compliance but that in and of itself does not provide specific indications as to the level of permissible countermeasures.[169]

arbitrators expanded their competences and, moreover, did so without examining the legal basis. The arbitrators could possibly have argued, for example, that under this dispute's circumstances the DSU implicitly granted them the competence to extend the period to comply, perhaps recurring to a dynamic teleological interpretation. This extension of competences is especially problematic since the period to comply set by arbitrators pursuant to Article 21.3 (c) DSU is subject to review by the AB, whereas the decision by the arbitrators pursuant to Article 22.6 DSU is not. However, it should be noted that Grossman and Sykes (2011: 136), do not seem to consider this issue as a problem.

164 Pauwelyn (2000: 346), Mavroidis (2000: 789–790).

165 *United States–Prohibited Subsidies on Upland Cotton* (Article 22.6), para. 4.58.

166 *United States–Prohibited Subsidies on Upland Cotton* (Article 22.6), para. 4.87.

167 *United States–Prohibited Subsidies on Upland Cotton* (Article 22.6), para. 4.112.

168 *United States–Prohibited Subsidies on Upland Cotton* (Article 22.6), paras. 4.63, 4.116, 4.199–4.202.

169 *United States–Actionable Subsidies on Upland Cotton* (Article 22.6), paras. 4.59–4.60.

Moreover, the arbitrators held that the SCM Agreement does not contain any basis for increasing the level of countermeasures 'to specifically take into account a superadded objective of inducing compliance'.[170] Instead, '[t]he objective of inducing compliance must be seen to arise from the ability of a Member to obtain an authorization, and not from an exaggeration of its permitted amount'.[171]

In conclusion, concerning the one-time subsidy, the arbitrators held the view that inducing compliance could not be considered as a purpose for countermeasures, yet they did not sufficiently take into account certain systemic implications. Regarding diachronically variable countermeasures, the arbitrators underlined the importance of proportionality between the trade opportunities affected by the subsidy and those affected by the countermeasure, thus notionally rebalancing obligations between the parties. Inducing compliance was considered not to provide specific indications for determining the level of permissible countermeasures. On actionable subsidies, it was also understood that inducing compliance did not provide specific indications for the level of countermeasures and did not justify an increase in that level. Moreover, the arbitrators held that inducing compliance evolves from the Members' ability to introduce countermeasures.

15. Other disputes

Not only arbitrators pursuant to Article 22.6 DSU have dealt with the purpose of suspending obligations. This section addresses three examples.

While discussing if a certain measure could be considered as a suspension of obligations that contravened Article 23 DSU, the panel in *US–Certain EC Products*[172] expressed that the 'the principal object and purpose of DSB authorized suspension of concessions or other obligations is … to restrict trade to an extent equivalent to the trade affected by the incompatible measure'. The panel added that '[t]he major purpose of the WTO compatible suspension of concessions is to involve other interest groups from the Member at fault in order to induce compliance of that Member. The ultimate object of WTO authorised suspensions of concessions or other obligations is to remove WTO benefits and, therefore, probably to stop some trade.'[173] These words reflect the common view of suspension as a tool to both rebalance obligations and induce compliance.

170 *United States–Actionable Subsidies on Upland Cotton* (Article 22.6), para. 4.62.

171 *United States–Actionable Subsidies on Upland Cotton* (Article 22.6), para. 4.62.

172 Report of the Panel, *United States – Import Measures on Certain Products from the European Communities* (WT/DS165/R), 17 July 2000; henceforth *US–Certain EC Products (Panel)*.

173 *US–Certain EC Products (Panel)*, para. 6.82.

The arbitrators in *US – Section 110(5) Copyright Act*[174] made a brief reference to the object and purpose of the DSU as being 'to contribute to the prompt settlement of a dispute between Members, as commanded by Article 3.3 of the DSU'.[175]

In *US–Continued Suspension (Panel)*[176] and *Canada–Continued Suspension (Panel)*,[177] the panel expressed that 'one of the main objects and purposes of sanctions is to induce compliance by the violating WTO Member with its obligations' to underline that the suspension of concessions or other obligations had a temporary nature.[178] The panel did not analyze in depth the purpose of suspending obligations but used this assertion as an argument that supported a line of reasoning. In addition, it mentioned both rebalancing of obligations and inducing compliance as if they formed a unit.[179] This corresponds to the usual notion that suspending obligations serves both purposes.

16. The three-step approach to the purpose of suspension of obligations

Arbitrators pursuant to Article 22.6 DSU have discussed whether the purpose of WTO suspension of obligations is to induce compliance or to rebalance obligations and if these purposes are hierarchically ranked.

It is possible to systematize the WTO's jurisprudence regarding the purpose of suspension of obligations as three steps that serve differing purposes.[180] WTO jurisprudence has often not been explicit about these steps, but it is possible to infer them.

The first is a general step. The general purpose of WTO suspension is to induce compliance and expresses itself in the fact that complaining parties have the right to request the authorization to suspend concessions or other obligations as long as the requirements set out in the DSU are met. In other words, the right by itself to suspend concessions or other obligations shows that the complaining party has the

174 Decision by the Arbitrators, *United States – Section 110(5) of the US Copyright Act*, Recourse to Arbitration Under Article 25 of the DSU (WT/DS160/ARB25/1), 9 November 2001; henceforth *US–Copyright Act (Article 25)*.

175 *US–Copyright Act (Article 25)*, para. 2.5.

176 Report of the Panel, *United States – Continued Suspension of Obligations in the EC – Hormones Dispute* (WT/DS320/R), 31 March 2008; henceforth *US–Continued Suspension (Panel)*.

177 Report of the Panel, *Canada – Continued Suspension of Obligations in the EC – Hormones Dispute* (WT/DS321/R), 31 March 2008; henceforth *Canada–Continued Suspension (Panel)*.

178 *US–Continued Suspension (Panel)*, para. 4.37, *Canada–Continued Suspension (Panel)*, para. 4.37.

179 *US–Continued Suspension (Panel)*, paras. 4.135, 4.145, 4.196, 4.197, 4.203.

180 Albeit in a different context, for different reasons and with a different rationale, it is interesting to note that the ICJ adopted two steps that bear some resemblance to the WTO three-step approach: Regarding the countermeasure's lawfulness, in a first step, it analyzed whether the countermeasure was proportionate. The second step referred to whether the countermeasure's purpose was to induce compliance. See ICJ, Case Concerning the Gabcíkovo-Nagymaros Project (Hungary/Slovakia), judgement of 25 September 1997, para. 87.

right that the respondent withdraws the WTO-inconsistent measure (and the responding party has the corresponding obligation).

The second step refers to the level of suspension. This level is explicitly regulated by WTO law and depends on the subject matter. As a general rule, the suspension of concessions or other obligations shall be equivalent to the level of the nullification or impairment (Article 22.4 DSU). Regarding prohibited subsidies, countermeasures have to be appropriate (Articles 4.10 and 4.11 SCM Agreement). Concerning actionable subsidies, countermeasures have to be commensurate with the degree and nature of the adverse effects determined to exist (Articles 7.9 and 7.10 SCM Agreement). These three standards[181] determine a ceiling to the level of suspension that WTO jurisprudence has usually defined in relation to the consequences of the WTO illegal measure to the complaining party. Above this ceiling of correspondence, suspension of obligations becomes what has been termed as punitive.

Regarding this second step, WTO jurisprudence is rather heterogeneous. The view has crystallized that suspension set in accordance with Article 22.4 DSU or Articles 7.9 and 7.10 SCM Agreement should not exceed certain levels that correspond to the level of nullification or impairment suffered by the complaining party.[182] Thus, WTO jurisprudence has eschewed so-called punitive sanctions even though they could help induce compliance. In other words, the purpose of rebalancing obligations has been held as hierarchically superior to inducing compliance.

In disputes about prohibited subsidies (Articles 4.10 and 4.11 SCM Agreement), WTO jurisprudence is rather ambiguous about the second step. On the one hand, arbitrators seem to have understood their task as setting an upper limit to countermeasures and, in practice, they have often substantially reduced the level of suspension that the claiming parties had proposed.[183] Thus, it does not seem that the arbitrators have considered inducing compliance as the principal purpose of suspension.[184] Yet arbitrators in these disputes have not clearly endorsed rebalancing obligations either. They have concluded that inducing compliance can be a relevant criterion for setting the level of appropriate countermeasures, for example, when the level of nullification or impairment is not exactly defined, when countermeasures are not allocated or when the defending party has admitted it would not comply with an adverse ruling. Hence, some arbitrators have determined levels of suspension of obligations that can be understood as being

181 A fourth standard concerns non-actionable subsidies in which case appropriate countermeasures shall be commensurate with the nature and degree of the effects determined to exist (Article 9.4 SCM Agreement). So far countermeasures regarding non-actionable subsidies have not been requested and, consequently, there is still no relevant jurisprudence on this topic.

182 See, for example, *US–Gambling* (Article 22.6), paras. 2.7, 3.24, 3.27.

183 The exception is *US–FSC* (Article 22.6).

184 See, for example, *US–Prohibited Subsidies on Upland Cotton* (Article 22.6), para. 4.113.

punitive. However, they have not explicitly acknowledged it, but have often insisted that punitive countermeasures are not allowed by the DSU. Thus, argumentatively they have relied, to a very large extent, on the purpose of rebalancing obligations, while the outcome of some arbitral decisions has corresponded, in part, to inducing compliance. As a consequence, in my view, these arbitrators have left open the question about the purpose of suspension.

As a last comment on this second step, it should be noted that in some disputes where the level of suspension has been determined according to Article 22.4 DSU or Articles 4.10 and 4.11 of the SCM Agreement, claiming parties have requested a diachronically variable suspension level. Arbitrators have consistently allowed it. This kind of suspension could strongly influence the incentives for compliance, while observing the correspondence between the level of nullification or impairment and the level of the suspension of obligations. In other words, if applied correctly, it can be an interesting tool that induces compliance without punitive sanctions.

The third step concerns the suspension's content, that is, what concrete concessions or obligations are suspended (for example, raising specific tariff rates). At this step, arbitrators have granted a great deal of leeway to complainants. As long as complainants follow the principles and procedures set out in Article 22 DSU, they have been allowed to shape the qualitative elements of suspension without constraints, particularly, to strengthen the incentives for inducing the defendant to comply while keeping at bay the suspension's negative effects for the complainant himself.[185] For example, arbitrators have so far imposed only marginal restrictions to the complainants' requests for so-called cross retaliation according to Article 22.3 lit. b and lit. c DSU.[186] The liberty accorded to complainants regarding the content of the suspension is consistent with the more general deference that WTO dispute settlement organs show for the WTO Members' sovereignty, and, for example, mirrors the liberty defendants have when implementing the DSB's recommendations and rulings as long as they comply with the WTO law requirements.[187] Probably the main exception is so-called carousel sanctions, which arbitrators and some WTO Members seem to have regarded with some misgivings despite being coherent with the freedom complainants have regarding the content of suspended obligations.

Keeping these three steps in mind, it should help to easier understand the rationale behind the WTO jurisprudence on the purpose of suspending obligations. Additionally, it will hopefully be easier to understand why some arbitrators have

185 In particular, see *EC–Hormones (US/Canada)* (Article 22.6), paras. 18–19, and *US–Gambling* (Article 22.6), paras. 2.10–2.12, 5.1–5.13.

186 *EC–Bananas III* (Article 22.6 – Ecuador), paras. 65–138; *US–Gambling* (Article 22.6), paras. 4.1–4.119; *US–Upland Cotton* (Article 22.6), paras. 5.1–5.236.

187 For example *EC–Hormones* (Article 21.3), para. 38; *Australia–Salmon* (Article 21.3), para. 35, *Korea–Alcoholic Beverages* (Article 21.3), para. 45, und *US–Gambling* (Article 22.6), para. 3.24.

insisted that suspending obligations induces compliance and simultaneously rebalances obligations.[188]

17. Conclusions

This article examined how WTO jurisprudence has understood the purpose of the suspension of obligations. First, it succinctly highlighted the differing views held by the VCLT and the AB on teleological interpretation. Then it offered some insights into the purpose of suspension from the perspective of public international law as well as the history and the present of WTO law. Next, this article examined GATT and WTO jurisprudence that has referred to the purpose of suspending obligations. Finally, it offered a three-step approach that can help in understanding the WTO jurisprudence on the purpose of suspending obligations. The first step consists of inducing compliance as the general purpose since complaining parties have the right to request the authorization to suspend obligations when the requirements defined in the DSU are met. The second step involves the level of suspension and, in this regard, WTO law prescribes different standards. Jurisprudence is rather heterogeneous on this matter. In general, rebalancing obligations has been accorded a somewhat higher hierarchy than inducing compliance as so-called punitive sanctions have, in general, not been allowed. However, in some disputes regarding prohibited subsidies, punitive sanctions were allowed but, somewhat contradictorily, arbitrators stressed the importance of rebalancing obligations. The fact that diachronically variable suspension levels have been allowed also corresponds to the purpose of inducing compliance. The third step relates to the content of the suspension. As long as complaining Members follow the principles and procedures defined in Article 22 DSU, arbitrators have, in general, granted them freedom, particularly to strengthen the effect of the suspension on inducing the defending Member to comply. These three steps can hopefully help to better understand WTO jurisprudence on the purpose of suspending concessions or other obligations.

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188 Jürgensen (2005: 328).

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