RENEGOTIATING REMEDIES IN THE WTO: A MULTILATERAL APPROACH

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I. INTRODUCTION

A. THE WTO DS SYSTEM HAS LITTLE MEANING FOR THE LDC GROUP

There is a pervasive sentiment among developing and least developed countries ("LDC") that the World Trade Organization (WTO) dispute settlement (DS) system's enforcement is ineffective and is therefore meaningless. As the members of the LDC Group made clear[2] during the ongoing negotiations of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") (with express reference to the *EC – Bananas – Ecuador (Article 22.6 – EC)* case[3]): "the question of little or no utilization of the WTO DS by developing and least-developed

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[2] India and other nine developing countries expressed a similar view on communications proposing changes in the burden of proof relating to the "practicable or effective" test of Article 22 of the DSU. Permanent Mission of India on behalf of Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe, Communication, *Negotiations on the Dispute Settlement Understanding*, TN/DS/W/19 (Oct. 9, 2002), at 1 [hereinafter Indian Proposal]. By doing so, these countries repeated the requests that other developing countries (namely Brazil and Uruguay) made during the 1950-1960s for a "collective retaliation" scheme. *See* E/Conf.2/C.6/W.64 and W.66. *See also* ROBERT E. HUDEC, THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY, at viii, 6, 226, 242 (2d ed. 1990) [hereinafter HUDEC, GATT LEGAL SYSTEM], viii, 226 and 242.

[3] 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 - Decision by the Arbitrators, WT/DS27/ARB (Apr. 9, 1999) [hereinafter April 9 Recourse to Arbitration]. Reference made because of the difficulties Ecuador faced in making the European Communities comply with the WTO Dispute Settlement Body (DSB)' s recommendation.

country Members has been linked to the inadequacies and structural rigidities of the remedies available to poor countries that successfully litigate a dispute before the DS."[4] The LDC Group suggests that compensation be mandatory[5] and calls for the implementation of a system of "collective retaliation":

> [T]he lack of an effective enforcement mechanism and the potential negative impact of retaliatory measures for poor economies is well documented. LDCs are of the view that one solution to this handicap is to adopt a "principle of collective responsibility" akin to its equivalent under the *United Nations Charter*. Under this principle, all WTO Members would collectively have the right and responsibility to enforce the recommendations of the DSB. In the case where a developing or least-developed country Member has been a successful complainant, collective retaliation should be available automatically, as a matter of special and differential treatment. In determining whether to authorize collective retaliation, the DSB should not be constrained by quantification on the basis of the rule on nullification and impairment.

This statement is of capital importance, especially given that "[t]o date, no least-developed country (LDC) Member has sought to resolve a trade dispute through the WTO dispute settlement system (DS)."[6] The reasons lie in the structure of the WTO DS itself, as the LDC Group made clear: "however, this is definitely not because these countries have had no concerns worth referring to the DS, but rather due to the structural and other difficulties that are posed by the system itself."[7]

Hudec qualifies the lack of adoption of collective retaliation as a "serious flaw in the basic structure of WTO legal remedies."[8] Although he admonishes against overstating the importance of

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[4] Permanent Mission of Zambia on behalf of the LDC Group, Communication, TN/DS/W/17 (Oct. 9, 2002) [hereinafter LDC Group Proposal].

[5] LDC Group Proposal, at ¶ 13.

[6] *Id.* at 1.

[7] *Id*.

[8] Robert E. Hudec, *Broadening the Scope of Remedies in WTO Dispute Settlement*, *in* IMPROVING WTO DISPUTE SETTLEMENT PROCEDURES: ISSUES AND LESSONS FROM THE PRACTICE OF OTHER INTERNATIONAL COURTS AND TRIBUNALS 345–76 (Friedl Weiss ed., 2000) [hereinafter Hudec, *WTO Dispute Settlement*].

such a device for developing countries (the use of collective remedies would not be certain), Hudec states that developed countries have blocked initiatives to adopt such a system because they "are quite comfortable with membership in a legal system where they can hurt others but some of the other cannot really hurt them." Pauwellyn[9] and Mavroidis[10] have also pointed out that the adoption of a more collective approach in the WTO DS remedies would be desirable, at this current stage of the development of the WTO DS system.

There is clearly something wrong with a system that does not provide the majority of its Members with effective means to obtain compliance from other Members. Under the WTO DS, the WTO Members are expected to fully and promptly comply with the recommendations of the Dispute Settlement Body (DSB) (Article 22.1, DSU). If a Member does not comply with a DSB's recommendation, the complaining Member may request authorization from the DSB to apply temporary measures, including compensation and the suspension of concessions or other obligations (or "retaliation") against the complained WTO Member (Article 22.2, DSU).

The actual process of adjudication of a dispute between Members under the WTO DS is, for the most part, effective. Most of the major deficiencies previously complained of were remedied as the result of the Uruguay Round negotiations. The enforcement portion of the WTO DS, however, still requires further development in order to keep pace with the significant changes the WTO regime has undergone the last sixty years. Most importantly, those changes suggest that the WTO DS should no longer be seen as a system that seeks only to provide means for Members in a bilateral relationship to restore the balance of their exchanges.

The LDC Group's proposition for the adoption of a multilateral/collective action system of enforcement seems attractive. Under this system, imbalances of trade would be less likely to prevent stronger Members from complying with their obligations

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[9] Joost Pauwelyn, *Enforcement and Countermeasures in the WTO: Rules are Rules – Toward a More Collective Approach*, 94 AM. J. INT'L L. 335 (2000).

[10] Petros C. Mavroidis, *Remedies in the WTO Legal System: Between a Rock and a Hard Place*, 11 (4) E.J.I.L. 763, 810–11.

when dealing with weaker Members. Indeed, effective enforcement of WTO rules is crucial under the WTO regime in order to not put cooperation at risk, as demonstrated below. Moreover, the improvement of coercive models of enforcement is adequate under the WTO regime, along with managerial techniques.

This paper aims to provide further grounds in support of the adoption of a multilateral system of enforcement under the WTO DS. It also discusses issues of whether and to what extent such a system would be justifiable and desirable under the WTO/GATT regime (Chapter II). Without prejudice to other theories, this paper benefited from concepts stemming from the following perspectives: Hartinian theory, game theory, collective action theory, transaction costs theory, constructivism, contract theory and managerialism. This paper draws attention to two propositions consistent with the multilateral/collective action approach. The first is a theoretical proposition that demonstrates the viability and the advantages of implementing this approach (Chapter III.A). The second one is a negotiating proposition already submitted by Mexico for consideration on the WTO negotiations (Chapter III.B), which calls for the creation of "negotiable rights" of retaliation. Although imperfect, this proposal may become a first step towards collective retaliation under the WTO DS system. Chapter IV concludes.

II. Considerations About the Compliance Puzzle

The issues at stake are all part of the so-called "compliance puzzle" depicted in Henkin's classical rule: "*[a]lmost all nations observe almost all principles of international law and almost all of their obligations almost all of the time*."[11] The answer to this puzzle logically precedes any discussion of the ideal system of enforcement of the decisions of the WTO DS. If it is true that compliance is the rule, why then in some situations do countries not comply with their international obligations? How can an international regime be improved so as to increase compliance with its rules? And finally, does it matter that members of an international regime do not comply with its rules? Is there a risk involved in non-compliance? Several schools of thought have

[11] Louis Henkin, How Nations Behave: Law and Foreign Policy 47 (2d ed. 1979).

considered this question. Their contribution to an understanding of the compliance puzzle will be briefly reviewed below.[12]

A. Brief Overview

By the end of the 19th century, four different schools of thought had attempted to explain the compliance puzzle. The first one was the Austinian school,[13] according to which international law was not law *per se* but rather a merely "positive international morality" and ought to be enforced through moral sanctions.[14] Secondly, the Hobbesian-utilitarian view argued that nations do obey international obligations, but only when the result of such action is in keeping with their self-interest. Thirdly, Kant introduced his theory of international law in *Perpetual Peace*, arguing that an alliance of liberal democracies united by their moral commitment to individual freedom would be the basis for achieving "perpetual peace."[15] Finally, Bentham proposed achieving perpetual peace by suggesting the writing down of uncertain customary rules (predictability) and the establishment of "a common court of judicature" (adjudication).[16]

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[12] A review of each and every theory explaining the compliance puzzle is not within the scope of this paper. Harold Hongju Koh, *Why Do Nations Obey International Law?*, 106 Yale L.J. 2599 (1997) [hereinafter Koh, *Why Nations Obey*], presents an excellent account on that topic.

[13] In 1832, John Austin advocated a positivist view of international law under which the quality of a rule as law was dependent on its issuance by a sovereign and its habitual obedience under threat of punishment. Underlying the Austin's idea was the "traditional" notion that "sovereignty" played a central role in the construction of municipal and international orders (the Treaty of Westphalia is seen as the event marking the advent of the "traditional international law", based on principles of territoriality and state autonomy). Such a dichotomy rested on the notion of legal obligation as a distinctive factor. *See id.* at 2607–08.

[14] (Thus, arguably nations would never obey international obligations) *Id.* at 2608–09. "The duties which [international law] imposes are enforced by moral sanctions: by fear on the part of the nations, or by fear on the part of sovereigns, of provoking general hostility, and incurring its probable evils, in case they shall violate maxims generally received and respected." John Austin, The Province Of Jurisprudence Determined and the Use of the Study of Jurisprudence 201 (1832), *cited in* Koh, *Why Nations Obey*, at 2608–09.

[15] For an analysis of Immanuel Kant's *To Perpetual Peace: A Philosophical Sketch*, *in* Perpetual Peace And Other Essays 107 (Ted Humphrey trans., 1983), see Fernando R. Teson, *The Kantian Theory Of International Law*, 92 Colum. L. Rev. 53 (1992).

[16] Bentham's plan is generally depicted as positivist and process-based. Koh, *Why Nations Obey*, *supra* note 12, at 2611.

During the interwar period (between World Wars I and II), Verdross proposed assessing international obligations from a perspective of a commonality of values and interests (the international community as a key factor).[17] The aftermath of the World War II saw the contribution of two ius-philosophers who addressed the issue of whether international law existed but also submitted relevant concepts to the compliance issue as well.

B. Hart's Concept of Law

Hans Kelsen qualified international law as a primitive system of law, based on *self-help* (particularly because of the lack of a "coercive order"[18]). In contrast, H.L.A. Hart submitted that international law lacks legislature in that "states cannot be brought before international courts without prior consent, and there is no centrally organized effective system of sanctions."[19] Hart's contribution should be coupled with his theory of "primary" and "secondary" rules. The former are rules stating positive duties or forbidden actions to be observed by the members of a society. The latter are rules stating the ways that primary rules shall be "ascertained [*rules of recognition*[20]], introduced, eliminated, varied [*rules of change*] and the fact of their violation conclusively determined [*rules of adjudication*]." The secondary rules are the rules that help shape the foundations of a "true" legal system.

Unlike Kelsen, Hart is not normative in *tout court* classifying international law as a primitive legal system because of the lack of a coercive order or of a "rule of recognition" (Kelsen's "basic norm").[21] Instead, Hart acknowledges the character of international rules as international law. Absent secondary rules, however, Hart sees international rules only as a "set" of rules, not as

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[17] Koh suggests that this approach would be a mixture of Bentham's process-based (managerial) approach with *reputation*. *Id.* at 2613.

[18] Hans Kelsen, Principles of International Law 417–18 (1952), *quoted in* Koh, *Why Nations Obey*, *supra* note 12, at 2616 n.70.

[19] H.L.A. Hart, The Concept of Law 3–4, 91–99 (2d ed. 1994).

[20] "The rules of recognition seem to be a concept similar to Hans Kelsen's "basic norm." Hans Kelsen, Pure Theory of Law 214–21 (Max Knight trans., 1967). Hart is clear about such similarity: "Kelsen. . .insist[s] that like municipal law, international law possesses and indeed must possess a 'basis norm' or what we have termed a rule of recognition. . ." Hart, *supra* note 19, at 233.

[21] Hart, *supra* note 19, at 218.

an unified system (international law would thus resemble a regime of primitive society).[22] Interestingly, Hart later concedes that a multilateral set of treaties may amount to the equivalent of basic rule of recognition, elevating such a primitive legal system to a higher level.[23]

The WTO DS system may be understood from a Hartinian perspective.[24] Palmeter submits that (i) the *rules of recognition*[25] can easily be identified as the GATT treaty itself,[26] from Hart's "internal point of view," (ii) in relation to the *rules of change*, the traditional consensus rule was maintained (Article XI(1)) although other rules of change were modified,[27] and (iii) the *rules*

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[22] *Id.* at 234–35.

[23] *Id.* at 236 ("Perhaps international law is at present at a stage of transition towards acceptance of this and other forms which would bring it nearer in structure to a municipal system.")

[24] For an analysis of the DSU from a Hart's perspective *see* David Palmeter, *The WTO as a Legal System*, 24 FORDHAM INT'L L.J. 444 (2000) (submitting that WTO legal system is very far from a primitive system, considering the remarkable developments on rules of adjudication and the less notable on rules of change).

[25] *Id.* at 467. Articles I and subsequent articles (establishing the organization, its scope, function, organization, structure, forms of accession, acceptance of Members and entry into force) and II.(2) (providing the agreements and associated legal instruments included in its Annexes 1, 2 and 3, dealing respectively with trade in goods, in services and intellectual property) of the WTO Agreement. *Id.*

[26] "As Hart might say, such rules are not assumed, postulated, or hypothesized. They are presupposed. They are *used*." *Id.* at 467–68. Indeed, according to HART, *supra* note 19, at 102–04: "[S]ome writers, who have emphasized the legal ultimacy of the rule of recognition, have expressed this by saying that, whereas the legal validity of other rules of the system can be demonstrated by reference to it, its own validity cannot be demonstrated but is 'assumed' or 'postulated' or is a 'hypothesis.'" In treaty regimes, it is conceived that the treaty is the rule of recognition in itself: "treaties are the most unproblematic source of international law." ABRAM CHAYES & ANTONIA HANDLER CHAYES, THE NEW SOVEREIGNTY: COMPLIANCE WITH INTERNATIONAL REGULATORY AGREEMENTS 116 (1995), *cited in* Palmeter, *supra* note 24, at 455.

[27] Reference is made here to the adoption of the "negative consensus" rule, under which a panel's report will be adopted by the DSB unless it decides not to do so, unanimously. Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, art. 16.4, *available at* http://www.wto.org/english/docs_e/legal_e/28-dsu.pdf [hereinafter DSU].

of adjudication were relevantly changed to create a more effective dispute settlement system, by means of, *inter alia*, implementing a compulsory and exclusive jurisdiction[28] (Article 23, DSU), an automatic proceeding for the establishment of a panel, and the imposition of sanctions (without the possibility of the defendant party blocking the adoption of the panel's report by the Council[29]). Interestingly, these two changes alone tried to correct (in relation to the GATT system) the two major deficiencies Hart saw in the general international law system, *i.e.*, a lack of an automatic system to bring states to international courts and an organized coercive system.

Nonetheless, Palmeter points out that one of the remaining deficiencies of the WTO DS from Hart's perspective is the *inequality* of parties.[30] Hart contends that one of the differences between human and international life is that in the former, individuals are generally of approximate equality,[31] making it difficult for one of them to dominate or subdue the others for more than a short period of time. The fact of approximate equality, as Hart puts it, "more than any other, makes obvious the necessity for a system of mutual forbearance and compromise which is the base of both legal and moral obligation." Hart submits that the problem of the fact of *approximate equality* is dominant in the international order.[32]

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[28] The WTO/GATT turned into a compulsory and exclusive jurisdiction, thus forbidding the use of alternative methods to (i) assess the violation or non-violation nullification and impairment of WTO/GATT rules (DSU, *supra* note 27, arts. 23.1 and 23.2.(a)), (ii) determine the "reasonable period of time" to a party to a dispute to implement a WTO/GATT panel's ruling (*Id.* at art. 23.2.(b)) and (iii) calculate the quantum of retaliation in case the losing party in a dispute fails to comply with a WTO/GATT panel's ruling (*Id.* at art. 23.3.(c)).

[29] From 1980-1982, the U.S. filed nine complaints against the EC. Five resulted in the rulings by panels: four in favor of the U.S. and one in favor of the EC. None of the panel's reports was adopted by the CONTRACTING PARTIES because of losing party's blockage.

[30] Palmeter, *supra* note 24, at 472–74.

[31] *Approximate equality* is one of the five truisms—or salient characteristics of human nature—Hart points out, upon which the *minimum content* of Natural Law rests. The other four are: *human vulnerability*, *limited altruism*, *limited resources* and *limited understanding and strength of will*. HART, *supra* note 19, at 185–200.

[32] *Id.* at 195.

Hart also submits that this "truism" may undermine the force of sanctions (viewed as a "*guarantee* that those who would voluntarily obey would not be sacrificed to those who would not") particularly when strong men act opportunistically[33] to the detriment of the weak. In those cases, Hart explains that the application of sanctions would be ineffective and the harm produced therefrom could even amount to the level of the applied sanction itself. Hart further suggests that the weak men would come to gravitate around the stronger for "protection," leading to the creation of "conflicting power centres."[34]

The imbalance of forces in the application of sanctions in the context of the WTO DS is an example of this situation. The *EC – Bananas – Ecuador (Article 22.6 – EC)* case[35] illustrates this imbalance.[36] The Arbitrators' decision considered that the "circumstances" were "serious enough" for Ecuador to request suspension of concessions under another covered agreement (here, cross-retaliation under the TRIPS), having interpreted the concept of "seriousness" based on the guidance of the principles set forth in Article 22.3(c) (i) and (ii) (i.e., "the trade in the sector(s) under the agreements," "the importance of such trade to

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> [B]ut we need not have recourse to the fantasy of giants among pygmies to see the cardinal importance of the fact of approximate equality: for it is illustrated better by the facts of international life, where there are (or were) vast disparities in strength and vulnerability between the states. This inequality as we shall later see, between the units of international law is one of the things that has imparted to it a character so different from municipal law and limited the extent to which it is capable of operating as an organized coercive system.

Id.

[33] Hart does not use the word "opportunism" but such a concept is evident from the truism "limited understanding and strength of will", the explanation of which resembles one of the elements Oliver E. Williamson uses to justify the creation of firms: *bounded rationality*/*opportunism*. *See infra* note 127 and accompanying text. **R**

[34] HART, *supra* note 19, at 198

[35] *See* 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 – Decision by the Arbitrators, WT/DS27/ARB/ECU (Mar. 24, 2000) [hereinafter *EC – Bananas – Ecuador (Article 22.6 – EC)* case]. *See also* Palmeter, *supra* note 24, at 473.

[36] For a description and evaluation of the Bananas case, see Patricio Grane & John H. Jackson, *The Saga Continues: An Update on the Banana Dispute and its Procedural Offspring*, 4 J. INT'L ECON. L. 581 (2001).

the party" and "broader economic elements" and "consequences"). The remarkable importance of the trade in bananas for Ecuador's economy and the imbalance between trade flows and power between Ecuador and the EC were relevant factors in the Arbitrators' decision (retaliation on the sector of trade in primary and investments goods would cause an adverse effect on Ecuador's manufacturing and processing industries).[37]

The EC eventually modified its regulations so as to comply with its obligations under the WTO Agreements. However, it is not clear whether the EC would have complied[38] with the WTO DSB recommendation if the EC had not been involved in a "twin" dispute with the United States (involving EC's commitments on wholesales trade services within the sector of distribution services) and therefore pressured by the threat of Section 301 sanctions.[39]

Section 301 thus served as a "conflicting power centre" to the (indirect) benefit of Ecuador, in that the EC's failure to comply with its WTO obligations would trigger United States' Section 301 machinery. Thus, Ecuador benefited from the fact that the EC could not separate its obligations to the United States (the terms of the implementation of "Phase II" of the agreements entered with each of them were roughly identical). Absent this competing pressure, it seems doubtful whether the EC would have modified its internal regulation.

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[37] *Id.* at 587–88.

[38] On November 14, 2001, the Ministerial Conference waived (i) Article I of the GATT 1994 to permit the EC to comply with its trade commitments under the ACP-EC Partnership Agreement; and (ii) the requirements of Article XIII of the GATT 1994 (which the EC alleged provides legal security for the implementation of the transitional banana regime through autonomous tariff rate quotas on imports of bananas until December 31st 2005). European Communities – Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/51/Add.24 (Dec. 7, 2001). The EC communicated the taking of the necessary action to implement Phase II of the agreements as of January 1st, 2002. On January 21, 2002, the EC finally communicated the DSB (European Communities – Regime for the Importation, Sale, and Distribution of Bananas, WT/DS27/51/Add.25 (Jan. 21, 2002)) the adoption of Regulation (EC) No. 2587/2001 by its Council on 19 December 2001, by which EC implemented Phase 2 of the Understandings with the United States and Ecuador. OFFICIAL JOURNAL OF THE EUROPEAN COMMUNITIES: L 345 (Dec. 29, 2001).

[39] *See* April 9 Recourse to Arbitration, *supra* note 3.

During the GATT era, the United States' recourse to Section 301 (and other similar forms of unilateral action to open markets and persuade countries to abandon alleged unreasonable trade restrictions) amounted to a sort of "conflicting power center." Section 301's wide scope reached practically all areas of U.S. commerce, from trade in goods to intellectual property.[40] Bayard & Elliot counts that, from 1975 to 1993, 91[41] Section 301 cases were initiated: with 21 in the 1975-79 period, 21 in 1980-84, 31 in 1985-89 and 11 in the 1990-93 period.[42] According to various accounts, data suggest that Section 301 and other similar statutes successfully enabled the U.S. to achieve its economic interests.[43]

Many countries reacted against the United States' "aggressive unilateralism."[44] For the United States, GATT's failure in enforcing its own rules and rulings justified the adoption of these unilateral actions. According to Hudec, recourse to Section 301 amounted to a "justified disobedience," in that it was a limited alternative to a simple withdrawal of a contracting party from the GATT.[45] In his view, "justified disobedience" would be permissible when "the damage to the legal system caused by inaction in

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[40] As per Section 301, the term "commerce" encompasses services and foreign direct investment. 19 U.S.C. § 2411(d)(3)(B)(i) (1988).

[41] Bayard & Elliot excluded 19 cases from their statistical analysis for a number of reasons. The six 1989 Super 301 investigations were included. *See* THOMAS O. BAYARD & KIMBERLY A. ELLIOT, RECIPROCITY AND RETALIATION IN U.S. TRADE POLICY 59 (1994) [hereinafter BAYARD & ELLIOT].

[42] BAYARD & ELLIOT's study includes investigations both under Super 301 and Section 201. *Id.* at 60–61, Table 3.2.

[43] For Sykes, 58 out of 83 Section 301 cases were successful, amounting to 70 percent of success rate. Alan O. Sykes, *Constructive Unilateral Threats in International Commercial Relations: The Limited Case for Section 301*, 23 LAW & POL'Y INT'L BUS. 263, 307–16 (1992). *See also* BAYARD & ELLIOT, *supra* note 41, at 64–65.

[44] Expression used in AGGRESSIVE UNILATERALISM: AMERICA'S 301 TRADE POLICY AND THE WORLD TRADE SYSTEM (Jagdish Bhagwati & Hugh T. Patrick eds., 1990). On February 1989 a GATT Council meeting addressed the "U.S. unilateralism" issue. C/163, dated 16 March 1989.

[45] Robert E. Hudec, *Thinking About the New Section 301: Beyond Good and Evil*, *in* AGGRESSIVE UNILATERALISM: AMERICA'S 301 TRADE POLICY AND THE WORLD TRADE SYSTEM 113, 126–27 (Jagdish Bhagwati & Hugh T. Patrick eds., 1990) [Hudec, *Section 301*].

the face of deadlock will exceed the damage caused by some disobedient act trying to force a correction."[46] Thus, the use of unilateral measures such as Section 301 was "justified" in order to keep the system moving and to prevent it from falling (the "bicycle" idea), particularly to put pressure on the U.S. trading partners to include other issues such as intellectual property, services and investments within the GATT regime. Thus, Section 301 was a "necessary evil" both in relation to the lack of commitment to the negotiations and to the lack of a credible system of enforcement, where retaliation in addition to peer pressure was sometimes necessary.[47]

This "conflicting power centre" was restrained considerably with the introduction of compulsory and obligatory jurisdiction in the WTO DS. However, these reforms did not change the structure of the enforcement system of the "old" GATT. The system still rests on a bilateral basis in that, upon the DSB's authorization, it is for the complaining Member to apply retaliation (suspension of concessions or obligations) against the Member concerned, thus restoring the balance of concessions. In cases of inequality between the parties to a dispute, the suspension of concessions or obligations by a weaker Member may not suffice to induce the stronger Member to comply with the DSB's recommendations. Thus, absent any other "power centre" for the "protection" of weaker Members, the WTO enforcement system lacks effectiveness for the majority of its Members.

Hart's perspective, illustrated by the anecdotal example of the *Bananas* case, suggests that a "power center" for the protection of weaker Members should be considered under the WTO regime. The adoption of a multilateral (or a collective action) system of enforcement may be instrumental in achieving this objective. Under such a system, sanctions would not only be authorized but also applied in a multilateral manner if the complaining Member so requests. The multilateral approach would also be instrumental in undermining the incentives for the creation and/or development of "conflicting power centres."

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[46] *Id.* at 127.

[47] Hudec concedes that the major problem of Section 301 was its "one-sidedness": in case Section 301's standards were applied to the U.S. trade restrictions many of them would not pass the test. *Id*. at 148–52.

C. Rationalistic Instrumentalism

The rationalistic instrumentalism school studies the compliance puzzle from pure rationalistic terms through the use of rational choice theory and game theoretical frameworks, among others. International law is seen as "instruments whereby states seek to attain their interests in wealth, power and the like."[48] This view seems to elaborate on Henkin "cynic's formula", *i.e.*, that "nations will comply with international law only if it is in their interests to do so; they will disregard law or obligation if the advantages of violation outweigh the advantages of observance".[49] Henkin admonishes, however, that the "cynic's formula" should not be overestimated, since the rule is law-observance rather than law-violation as a great countervailing advantage is generally required for a nation to violate international law.[50] In these calculations, nations are assumed to act deliberately and rationally (the Hobbesian utilitarian view), although bounded rationality is not ignored.[51]

1. Game Theory, Cooperation and the WTO/GATT DS System

Perhaps one of the main contributions the game theory school brought to the understanding of the compliance puzzle is the study of states' behavior through game theoretical frameworks.[52] In a computer tournament experiment, Axelrod's

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[48] Koh, *Why Nations Obey*, *supra* note 12, at 2632.

[49] Henkin, *supra* note 11, at 49.

[50] *Id.*

[51] *Id.* at 50. Henkin presents the following elements to be considered in the calculation of the costs and advantages of law observance: (i) foreign policy reasons for observing law; (ii) the costs and advantages of a particular violation (especially the "response of the other nation"); (iii) the special features of multinational agreements (and multinational response) where there generally are interdependence of states and entanglement of interests; (iv) domestic influences in law observance or violation; (v) the political content of the agreement concerned. *Id.*

[52] Some scholars acknowledge that game theory frameworks may not encompass all the complexities of international relations, but are useful because of the clarity and rigor of analysis they provide. *See* Robert Axelrod, The Evolution Of Cooperation 19 (1984): "The value of an analysis without them is that it can help clarify some of the subtle features of the interaction—features which might otherwise be lost in the maze of complexities of the highly particular circumstances in which choice must actually be made. It is the very complexity of reality

classic study showed that the simple TIT-FOR-TAT strategy is the best strategy in a Prisoners' Dilemma game.[53] This strategy, primarily based on *reciprocity* (a player begins cooperating in the first round and in the following rounds imitates the last move of the other player) was paramount in winning Axelrod's tournament. Its other major characteristics are being *nice* ("never been the first to defect"), *forgiving* ("it forgives an isolated defection after a single response") and *retaliatory* ("it is always incited by a defection no matter how good the interaction has been so far").[54] Other relevant characteristics of TIT-FOR-TAT are its *clarity*, because it is easy to identify when the other player is using it,[55] and its *non-exploitability*, particularly for being easy to appreciate once met.[56] For Axelrod, these characteristics make TIT-FOR-TAT a robust strategy.[57]

Most importantly, Axelrod's findings demonstrate that cooperation will emerge as the maximizing strategy for participants in the game, provided players in a Prisoners' Dilemma game face a long-run perspective of interaction ("iterated Prisoners' Dilemma")[58] In a long-run perspective, for a strategy to be collectively stable (as the strategy used by all), defection is to be

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which makes the analysis of an abstract interaction so helpful as an aid to understanding." *See also* Duncan Snidal, *Coordination versus Prisoners' Dilemma: Implications for International Cooperation and Regimes*, 79 AM. POL. SCI. REV. 923, 925 (1985) (submitting that the use of ordinal 2×2 games sets aside some contextual and historical richness) [hereinafter Snidal, *Coordination*].

[53] The payoff structure in a Prisoners' Dilemma is generally depicted as DC (unilateral defection) > CC (mutual cooperation) > DD (mutual defection) > CD (unrequited cooperation). Kenneth A. Oye, *Explaining Cooperation Under Anarchy*, 38 WORLD POL. 1, 4–5 (1985). Axelrod uses *T* (temptation to defect) > *R* (reward for mutual cooperation) > *P* (punishment for mutual defection) > *S* ("sucker's payoff"). AXELROD, *supra* note 52, at 8.

[54] AXELROD, *supra* note 52, at 46.

[55] *Id.* at 54.

[56] *Id.* at 53.

[57] *Id.* at 54 ("What accounts for TIT-FOR-TAT's robust success is its combination of being nice, retaliatory, forgiving, and clear. Its niceness prevents it from getting into unnecessary trouble. Its retaliation discourages the other side from persisting whenever defection is tried. Its forgiveness helps restore mutual cooperation. And its clarity makes it intelligible to the other player, thereby eliciting long-term cooperation.")

[58] AXELROD, *supra* note 52, at 59 ("*Proposition* 2. TIT-FOR-TAT is collectively stable if and only if, *w* is large enough. This critical value of *w* is a function of the four payoff parameters, *T*, *R*, *P*, and *S*.")

punished vigorously and promptly,[59] otherwise fear of retaliation will not suffice to deter defection (which then may become the dominant strategy[60]). Furthermore, TIT-FOR-TAT is *maximally discriminating*, *i.e.*, it will eventually cooperate even if the other player has not cooperated yet, and once it cooperates it will always cooperate with another player using the same strategy. This characteristic makes it possible for a few users of TIT-FOR-TAT to invade clusters where another strategy is collectively stable – for example, ALL D – and to grow there from (the "ratchet effect"[61]). This demonstrates the effectiveness of reciprocity in building up cooperation in the long run.[62]

Rationality, altruism, and commitments are not necessary in developing cooperation under reciprocity.[63] Indeed, under the "Theory of Cooperation," a long-run perspective (or "the shadow of the future") is crucial as it makes the gains from cooperation higher than defection in the long run. In a cooperative equilibrium, a central authority is not needed. Deterrence of defection is achieved under the shadow of the future since fairness of transactions is guaranteed "by the anticipation of mutually rewarding transactions in the future."[64] Thus, cooperation based on reciprocity can be self-policing, leaving no role for a central authority (an external authority is generally invoked when the

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[59] In this sense, TIT-FOR-TAT provides for retaliation in the next round, punishing both players.

[60] A strategy is collectively stable when it is the strategy used by all in a territory. An invader may try to convert players in a territory to its own strategy (Axelrod uses the almost defect strategy, or ALL D). Such attempt will succeed in case the average payoff of ALL D (T) is higher than the average payoff of the population using TIT-FOR-TAT (R) in a territory. This is unlikely to happen when the prospect of the future (w) is large enough. "So in order for the population average to be no less than the score of the challenging ALL D, the interaction must last long enough for the gain from temptations to be nullified over future moves. This is the heart of the matter." *Id.* at 61.

[61] *Id.* at 189 ("This is the essence of the ratchet effect which was established in chapter 3: once cooperation based upon reciprocity gets established in a population, it cannot be overcome even by a cluster of individuals who try to exploit the others.")

[62] *Id.* at 66.

[63] *Id.* at 173.

[64] *Id.* at 178. *See also* Oye, *supra* note 53, at 13.

"shadow of the future" erodes).[65] The effect of vigorous and effective punishment on defection (*provocability*) plays a critical role in keeping cooperation as well as the building up of a reputation of being provocable, which is also germane in deterring defection (conditional defection strategy). However, if both players in a game intend to build this reputation simultaneously, TIT-FOR-TAT (reciprocity) may lead to a succession of retaliations in an "echo effect." In such a situation, Axelrod submits that a central authority may play a significant role in policing both sides, by establishing a "rule of law."[66]

Reciprocity is at the very heart of GATT's original design.[67] So, too, is the possibility of retaliation in case the other player does not abide by the rules of the agreement (the defection). Interestingly, under GATT, retaliation against a defection took place under a decentralized *managed* system of enforcement (under a "rule of law"), whereby the CONTRACTING PARTIES would approve the taking of action by the complaining contracting party against the defecting one (thus, in a *maximally discriminatory* manner), after having examined the nature of the claim and the level of the retaliation requested (Article XXIII, GATT). Clearly, this managed system of retaliation tried to avert the creation of trade wars (or the "echo effect"), which were the rule during the interwar period.

This structure reveals that the CONTRACTING PARTIES can be considered as an example of Axelrod's "central authority," the primary task of which was to manage the application of retaliation, in case of defection. Obviously, this is not to say that the CONTRACTING PARTIES were an authority with full *adjudicating and enforcement* powers. The GATT DS system encompassed both a "partially centralized managed system of adjudication" and a "decentralized managed system of enforcement." Indeed, as long as cooperation lasted among the contracting parties, the GATT

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[65] AXELROD, *supra* note 52, at 179.

[66] *Id.* at 186.

[67] The GATT explicitly adopted such a strategy as controlling in the international trade system, so as to facilitate cooperation among the contracting parties. *See generally* Duncan Snidal, *The Game Theory* of International Politics, 38 WORLD POL. 25, 49 (1985) [hereinafter Snidal, *Game Theory*]: "[t]he Tit-for-Tat strategy (i.e., reciprocate the other's last move) is effective only when the other state (in a bilateral situation) or a sufficient number of states (in a multilateral world) have adopted a compatible strategy."

system would be self-policing with no need for a ("legalistic") "central authority" substituting the unilateral action of its parties in respect to enforcement measures on their bilateral relations. "Diplomacy" would suffice. That is why it is said that GATT law was not intended to be enforceable.[68] This minimalist approach was in keeping with the "club-like" context of the GATT trade negotiations.

To sum up, three elements are critical in determining the likelihood of fostering cooperation: (i) the *mutuality of interests* (or mutual and conflicting preferences); (ii) *the shadow of the future*; and (iii) the *number of actors*.[69] These elements are instrumental in understanding other features of the original design of the WTO/GATT regime, its dispute settlement system, and the need to implement a multilateral system of enforcement.

(i) Mutuality of Interests.

The underlying idea of "mutuality of interests" is that the positioning of interests between players in a game determines the type of game being played[70] and therefore the payoff structure. Hence, "the greater the conflict between the players, the greater the likelihood that the players would in fact choose to defect."[71] Interestingly, some scholars submit that after wars, the payoff matrix for the victors may temporarily be one of a *Stag Hunt* game (where mutual cooperation is the maximizing payoff).[72] Such perceptions last for a "substantial momentum," although cooperation is subject to "fairly easy disruption." Indeed, once

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[68] HUDEC, GATT LEGAL SYSTEM, *supra* note 2, at 26 ("The point (and the international lawyers of the day may well have missed it) was that trade agreement obligations were not meant to be enforced to the letter.")

[69] Robert Axelrod & Robert O. Keohane, *Achieving Cooperation Under Anarchy: Strategies and Institutions*, 38 WORLD POL. 227, 928 (1985). *See also* Oye, *supra* note 53, at 14–15.

[70] There are myriad of types of games in game theory, being *Prisoners' Dilemma* (DC > CC > DD > CD), *Stag Hunt* (CC > DC > DD > CD) and *Chicken* (DC > CC > CD > DD) the ones generally used to analyze international relations. In these games cooperation is necessary to the realization of mutual benefits (for cooperation to exist, players must prefer mutual cooperation (CC) rather than mutual defection (DD)). Oye, *supra* note 53, at 6–9.

[71] Axelrod & Keohane, *supra* note 69, at 228.

[72] *Id.* at 229 (citing Robert Jervis, *From Balance to Concert: A Study of International Security Cooperation*, 38 WORLD POL. 58 (1985)).

recovery takes place, one or both parties may value cooperation less and relative gains more, dismantling the "mutuality of interests" and the payoff structure.

This seems to be exactly what happened with the GATT. The "miraculous"[73] creation of the GATT was part of the post-war momentum. The "embedded liberalism"[74] underlying the post-war period helped shape the concept that mutual cooperation in international trade was essential for this goal and should be pursued as the controlling strategy. The "embedded liberalism" amounted to the mutuality of interests necessary to foster cooperation in the beginning of the GATT regime.

An application by analogy of the Prisoners' Dilemma in relation to the history of the GATT indicates that calls for a stronger system of enforcement generally take place after critical changes in the payoff structure. Two changes are worth mentioning. The first was the creation of the EEC and the proliferation of preferential treatments, to the detriment of countries outside this web.[75] This led to the weakening of the MFN clause, one of the central pillars of the GATT system.[76] The *Chicken War* case in 1958 was

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[73] Richard N. Gardner, *The Bretton Woods - GATT System after Fifty Years: A Balance Sheet of Success and Failure*, *in* THE BRETTON WOODS-GATT SYSTEM: RETROSPECT AND PROSPECT AFTER FIFTY YEARS 181–95 (Orin Kirshner ed., 1996).

[74] GATT as the third leg of the economic institutions of the post-war period, along with the United Nations to make up the institutional machinery aiming the pursuance and maintenance of peace. "This was the essence of the embedded liberalism: unlike the economic nationalism of the thirties, it would be multilateral in character; unlike the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism." John Gerard Ruggie, *International Regime, Transactions, And Change: Embedded Liberalism In The Postwar Economic Order*, *in* INTERNATIONAL REGIMES 195, 209 (Stephen D. Krasner ed., 1983).

[75] *See generally* HUDEC, GATT LEGAL SYSTEM, *supra* note 2, at 207–10, 235–36.

[76] The EEC advocated the pragmatic "wait-and-see" approach as a way to accommodate the formation of the EEC in the GATT regime. Miguel Montana I Mora, *A GATT With Teeth: Law Wins Over Politics in the Resolution of International Trade Disputes*, 31 COLUM. J. TRANSNAT'L L. 103, 131–33 (1993), presents some explanations that might help understand EEC's pragmatic behavior: (i) diplomatic efforts were concentrated on the viability of the common market; (ii) the EEC had not itself negotiated the GATT's provisions; (iii) the EEC could not benefit from the grandfather laws; (iv) the organization of the EEC as a federation of states (need to accommodate different interests); (v) lack of a tradition to use trade related instruments (such as antidumping and the like); and (vi) of course, the need to accommodate the Common Agricultural Policy (CAP) within the GATT rules.

an excellent example of this weakening, although it did not involve a challenge to the legality *per se* of the EEC's Common Agricultural Policy (CAP) regime. Eventually, the U.S. applied authorized retaliation against EEC products (under "limited provocability"), but the CAP regime remained in place. With the payoff structure changed, incentives for the EEC to expand its preferential zone grew because retaliation was insufficient to deter defection (it seems that at that time the game's payoff changed from that of a *Stag Hunt* game to that of a *Prisoners' Dilemma* game). The lack of a central authority capable of deterring defection seems to have created incentives for the creation – a few years later (1962) – of a "successful" Hartinian-like parallel (unilateral) system of enforcement, in various forms, through voluntary exports restrictions (VERs) and coercive unilateral actions (for instance, Section 252 and, later, Section 301). It is no surprise that 25 percent of all Section 301 cases from 1975 to 1993 targeted the EEC/EC and 40 percent involved agricultural products.[77]

The second change in the payoff structure took place gradually with the growing need to address non-tariff barriers (as an effect of the lowering of tariff barriers) and the intent of the U.S. and other developed countries to include new issues in the GATT's agenda (as a result of the changed characteristics of its industries).[78] The inclusion of these issues in the Uruguay Round negotiations was a way to calibrate the payoff structure in relation to the developed countries and thus to restore the mutuality of interests. The use of Section 301' sanctions by the U.S. reveals its intent to include intellectual property rights under the GATT domain (along with services, financial services and telecommunications), since there was no remedy available at the international level to address the "violation" of intellectual property rights.

(ii) The Shadow of the Future.

When the GATT system was established, there was no doubt that the "shadow of the future" played an important role in maintaining reciprocity and cooperation amid GATT's contracting parties. Cooperation through the GATT was intended to last. Four

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[77] BAYARD & ELLIOT, *supra* note 41, at 57.

[78] *See generally* HUDEC, GATT LEGAL SYSTEM, *supra* note 2, at 103–13.

factors may contribute to making the shadow of the future "an effective promoter of cooperation," namely: (i) long time horizons; (ii) regularity of stakes; (iii) reliability of information about the others' actions; and (iv) quick feedback about changes in the others' actions.[79] For Axelrod & Keohane, the first two factors should be read jointly so that "neither side in an economic interaction can eliminate the other, or change the nature of the game decisively in a single move," making the games that they play iterated.[80] WTO Members value future interactions, a perception that seems to persist, in view of the growing worldwide interdependency of economies (iterated game). Furthermore, in order to enhance the perception of parties about the value of future interactions, the GATT system took steps towards making information about the others' actions more reliable, as discussed below (managerial regime).[81] Finally, the GATT contracting parties vigorously addressed the fourth factor, *i.e.*, the need to provide a "quick" feedback about changes in the others' actions. Improvements in the DSU provided the parties in a dispute with a faster adjudicating process, with automatic establishment of panels, and rules of thumb regarding time frames in a dispute, among other improvements. These improvements were the result of Tokyo Round's 1979 Understanding and its Annex on customary practice[82] and most importantly from the innovations introduced during the 1980s, by means of the 1982 Declaration,[83] the 1984 Decision,[84] the 1988 Montreal Midterm Agreement[85] and ultimately the DSU.

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[79] Axelrod & Keohane, *supra* note 69, at 232.

[80] *Id.* at 232–33.

[81] As a result of the Tokyo Round, the contracting parties reaffirmed their commitment to the publication and notification of measures affecting the operation of the GATT and established a surveillance system on any matters on which the CONTRACTING PARTIES made recommendations (1979 Understanding). As the result of the Uruguay Round, this system of surveillance was further improved. *See infra* note 225 and accompanying text. **R**

[82] Group "Framework" Point 3, Annex: Agreed Description of the Customary Practice of the GATT in the Field of Dispute Settlement (Article XXIII:2), MTN/FR/W/20/Rev. 2 [hereinafter Annex on customary practice].

[83] Ministerial Declaration, Thirty-Eighth Session, Nov. 29, 1982, GATT B.I.S.D. (29th Supp.) at 10 (1983) [hereinafter 1982 Declaration].

[84] In the same tone, in November 1984, the CONTRACTING PARTIES adopted a decision ("1984 Decision") creating a roster of private individuals to serve in panels. Those individuals would be at the disposal of the Director-General in case the

(iii) Number of Players.

Originally, the number of GATT's players was relatively low (22 original contracting parties) making detection of defection feasible and fear from "decentralized retaliation" present. To what extent does the increase in number of Members in the WTO/GATT regime (from 22 to 146) over the last fifty years undermine the effectiveness of "decentralized retaliation" as a deterrent to defection? Is the effectiveness of deterrence in a Two-Person game the same as it is in a N-Person game?

It is said that effective reciprocity depends on three conditions (the "sanctioning problems"): (a) the ability of players to identify defectors; (b) that players must be able to focus retaliation on defectors; and (c) that players must have sufficient long-run incentives to punish defectors. Failure to deal with these problems may put cooperation "in danger of collapsing."[86] The "sanctioning problems" have been dealt to varying degrees under the WTO DS domain, as pointed out below.

(a) The Ability of Players to Identify Defectors.

As the number of players increases, there are also proportionate increases in transaction and information costs. Therefore, the ability of players to anticipate the behavior of the other players and to weigh the value of the future interaction becomes more difficult. The probability of anonymous defections correspondingly grows. It has been submitted that the WTO may play a significant role in facilitating cooperation in this regard. First, the WTO's managerial system of collecting, disseminating and assessing information is one of the ways in which it facilitates the use of reputation mechanisms to support cooperation.[87] Second, the adjudicating powers[88] of the WTO DS, particularly the legal interpretation under the auspices of the Appellate Body, may reduce the

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parties to a dispute could not agree on the names of the panelists within 30 days. Ministerial Declaration, Fortieth Session, Nov. 27, 1984, GATT B.I.S.D. (31st Supp.) at 9–10 (1985) [hereinafter 1984 Declaration].

[85] *See, e.g.*, JOHN H. JACKSON, RESTRUCTURING THE GATT SYSTEM 64 (1990).

[86] Axelrod & Keohane, *supra* note 69, at 235. *See also* Oye, *supra* note 53, at 19–20.

[87] *See infra* note 225 and accompanying text. **R**

[88] Some pre-WTO studies suggested that GATT dispute settlement system served as an "information-gathering agency" able to discern between "true violations of

ambiguity in the agreements, improving the ability of the players to detect defectors.

(b) Players Must Be Able to Focus Retaliation on Defectors.

The ability to sanction defectors is crucial to prevent erosion of deterrence and cooperation. The limitations imposed on the use of Section 301 are instrumental in understanding this and the former sanctioning problem. Section 301 provided the U.S. authorities with broad discretionary powers to impose retaliatory actions against "unjustifiable," "unreasonable" and "discriminatory" trade barriers of other nations.[89] For the U.S., the strategy was successful in bringing its trade "partners" to the negotiating table and ultimately in changing contested measures.[90]

However, Section 301 retaliated against what *the U.S.* considered to be defections (because of the flexible concept of "unreasonable" trade barriers[91]). Most of the other players considered many of Section 301's retaliatory powers completely inadequate especially in allowing retaliation in cases where no GATT violation existed or where the level of retaliation exceeded the boundaries of reasonableness.[92] Significantly, as expressed during the negotiations of the Uruguay Round, the taking of action against wrong defectors threatened to erode considerably cooperation among GATT's Contracting Parties.[93]

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the agreement and mistaken perceptions." Thomas Hungerford, *GATT: A Cooperative Equilibrium in a Noncooperative Trading Regime?*, 31 J. INT'L ECON. 357 (1991) and Dan Kovenoch & Marie Thursby, *GATT Dispute Settlement and Cooperation*, 4 ECON. AND POL. 151–70 (1993), *cited in* Giovanni Maggi, *The Role of Multilateral Institutions in International Trade Cooperation*, 89 AM. ECON. REV. 190, 190 (1999).

[89] 19 U.S.C. § 2411(d)(4)(A) (1998).

[90] *See supra* note 43 and accompanying text. **R**

[91] It allowed the taking of action against acts, policies or practices that "while not necessarily in violation of or inconsistent with the international legal rights of the United States, is otherwise deemed to be unfair or inequitable." 19 U.S.C. § 2411(d)(3).

[92] *See* ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW – THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 230 (1993) [hereinafter HUDEC, ENFORCING TRADE LAW].

[93] C/163, dated 16 March 1989.

(c) Players Must Have Sufficient Long-Run Incentives to Punish Defectors.

In a Two-Person game, the costs of defection are concentrated entirely in the opposing player. In an N-Person game, the growth in costs of defection is directly related to the number of players. Thus, for a cooperating player, an effective retaliation may be too costly to deter defection of many defecting players. In addition, in an N-Person game, a "strategy of conditional defection can have the effect of spreading, rather than containing, defection."[94] By analogy, where WTO Members decide not to comply with the DSB's recommendations, a Member's defection erodes cooperation under the WTO regime itself, as many other Members will tend towards defection as their controlling strategy. Moreover, the weakening of the WTO DS system will generate incentives for strengthening parallel systems of enforcement. In a world of asymmetric powers, the system will tend to ultimately serve only the needs of the strong players which can develop parallel systems of enforcement.[95]

2. Regime Theory – Functionalists/Institutionalists

(i) Why Regimes.

Regimes can be defined as "sets of implicit or explicit principles, norms, rules and decision-making procedures around which actors' expectations converge in a given area of international relations."[96] Regimes are seen as intervening variables "standing between basic casual variables (most prominently, power and interests) and outcomes and behavior," which, once in place, "affect related behavior and outcomes."[97] From a utilitarian

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[94] "What happens if we increase the number of actors in the iterated Prisoners' Dilemma from 2 to 20? Confession by any of them could lead to the conviction of all on the major charge; therefore, the threat to retaliate against defection in the present with defection in the future will impose costs on all prisoners, and could lead to wholesale diction in subsequent rounds." Oye, *supra* note 53, at 20.

[95] Recall Hart's section above on the *EU – Bananas – Ecuador (Article 22.6 – EC)* case, *supra* note 35 and accompanying text.

[96] Stephen D. Krasner, *Structural Causes and Regime Consequences: Regimes as Intervening Variables*, *in* INTERNATIONAL REGIMES 1–2 (Stephen D. Krasner ed., 1982).

[97] Krasner accounts for the existence of three perspectives of the effects regimes may create in the behavior and outcomes of the basic causal variables, namely: (i)

perspective,[98] regimes in the international arena are created to deal with the collective (N-Person game) suboptimality that can emerge from individual behavior.[99] There is an inability of rational actors to reach a Pareto-optimal solution, "despite a certain degree of convergence of interests between them."[100] Countries thus make use of regimes in order to reach a Pareto-optimal equilibrium.[101]

Oye asserts that there are two strategies available for countries to deal with an N-Person game situation: "institutionalization" and "decomposition." "Institutionalization" (or regime creation), a "multilateral strateg[y],"[102] increases the likelihood of cooperation in N-Person games because the introduction of conventions provides rules of thumb that can diminish transaction and information costs.[103] As Keohane puts it, "international regimes perform the valuable function of reducing the costs of legitimate transactions, while increasing the costs of illegitimate ones, and/or reducing uncertainty."[104] Furthermore, international regimes alter the payoff structure of the game because states may internalize norms generated by the regimes and because information gathered under an international regime "may alter states' understanding of their interests."[105]

Additionally, the introduction of an international regime's collective enforcement mechanisms decreases the likelihood of

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the conventional structural strand suggests that regimes do not matter; (ii) the modified structural suggests that regimes may matter, "but only under fairly restrictive conditions;" and (iii) Grotian (liberals) which see regime as "inherent attributes of any complex, persistent pattern of human behavior." *Id.*at 5–6.

[98] This paper focuses on the prevailing explanation for the creation of regimes, *i.e.*, the egoistic self-interest (structural realist paradigm), since some of the other explanations (such as political power, usage and custom and knowledge) assume and/or take into consideration the self-interested behavior of states. *Id.* at 10–21.

[99] Artur A. Stein, *Coordination and Collaboration: Regimes in an Anarchic World*, *in* INTERNATIONAL REGIMES 115, 123 (Stephen D. Krasner ed., 1982).

[100] ROBERT O. KEOHANE, AFTER HEGEMONY 68 (1984) [hereinafter KEOHANE, HEGEMONY].

[101] Robert O. Keohane, *The Demand for International Regimes*, *in* INTERNATIONAL REGIMES 141, 150 (Stephen D. Krasner ed., 1982) [hereinafter Keohane, *Demand*].

[102] Oye, *supra* note 53, at 11.

[103] *See id.* at 20–21.

[104] KEOHANE, HEGEMONY, *supra* note 100, at 107.

[105] *See* Oye, *supra* note 53, at 11.

autonomous defection and permits selective punishment of violators of norms (*maximally discriminatory*[106]).[107] Yet the role of a system of enforcement is crucial in correcting the shortcomings of an N-Person game, because the incentives for compliance are significantly smaller in such a setting than in smaller communities. If enforcement of a regime's rules is not possible, cooperation is at risk, since countries will prefer cheating to cooperating; the reverse also holds, if binding agreements are enforceable.[108]

(ii) Regimes as a Transaction Costs Economizing Tool.

Building upon the Coase theorem,[109] Keohane submits that when at least one of the following three conditions is present, "independent utility-maximizing actors in world politics" will value international regimes as better substitutes for *ad hoc* agreements: (a) a lack of a clear legal framework establishing liability for sanctions; (b) information imperfections (information is costly); and (c) positive transactions costs (includes organization costs and costs of making side-payments).[110] Keohane submits that all of these conditions are present in world politics. Along with these conditions, international regimes are more likely to appear where density of the issue-area is high (*issue-density*), *i.e.*, where substantive objectives may well impinge on one another and regimes will help countries to achieve economies of scale (for instance, in the bargaining process).[111] The interdependence of substantive issues where the bargain over one area depends on

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[106] *See supra* note 61 and accompanying text. **R**

[107] Oye, *supra* note 53, at 20–21.

[108] As Duncan Snidal puts it: "[I]f enforcement agreements are not possible, then neither state will cooperate, because each will be better off not cooperating regardless of what the other does. If binding agreements can be made, then both states will find it in their interests to enter into agreement to cooperate." Snidal, *Coordination*, *supra* note 52, at 927. Keohane also emphasizes the need to establish "sanctions for violation of regime principles or rules" even under the decentralized institutions of international regimes. KEOHANE, HEGEMONY, *supra* note 100, at 98.

[109] Ronald Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

[110] Keohane, *Demand*, *supra* note 101, at 154.

[111] Conversely, "where issue density is low, *ad hoc* agreements are quite likely to be adequate: different agreements will not impinge on one another significantly, and there will be few economies of scale associated with establishing international regimes (each of which would encompass only one or a few agreements)." *Id.* at 156.

the bargain of another (*linkage*) arises organizational costs, which makes calls for international regimes (understood as the establishment of "rules, norms, principles, and decision making procedures") stronger.[112] International regimes "facilitate side-payments among actors within issue-areas covered by comprehensive regimes, since they bring together negotiators to consider a whole complex of issues,"[113] thus facilitating cooperation.

(iii) The GATT Regime.

The GATT system amounted to an international regime. It established a body of international law (or the regime theorists' "rules, norms, principles, and decision making procedures"[114]) regulating international trade and included dispute settlement mechanisms that sought to ascertain property rights and liability for sanctions. Indeed, dispute settlement system makes identification of defectors possible and application of sanctions discriminatory in nature. The GATT regime also helped diminish the transaction costs relating to: (a) the operation of international trade *per se*, such as the application of rules of origins, different tariffs for different countries etc.; (b) the bargaining process, in a substantive dimension, by making possible multilateral negotiations, and in an operational dimension, by providing means for the organization of negotiations in itself, in the form of a forum for negotiations in rounds; and (c) the problem of information imperfections, most notably for making the publication of bounded tariffs mandatory.

(iv) Changes and the WTO/GATT Regime – The Institutionalization.

Over the years, the GATT regime experienced significant transformations. A significant increase in the number of participants turned it into a N-Person game rather than a simple set of bilateral Prisoners' Dilemma arrangements, severing both the

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[112] *Id.*

[113] *Id.*

[114] There is no doubt that from a legal perspective, the "rules, norms, principles and decision-making procedures" the regime theorists refer to is nothing more than international law. CHAYES & CHAYES, *supra* note 26, at 303 n.3, *cited in* Koh, *Why Nations Obey*, *supra* note 12, at 2625.

"sanctioning problems" and the informational imperfections as well as increasing bargaining and transaction costs. The increasing incorporation of new issues to the original "naked" GATT framework (quantitative restrictions and tariffs are part of an unique issue-area[115]) – the addition of trade in services, intellectual property, health, environment, technical barriers to trade, investment, government procurement, and telecommunications – led to a substantial increase in issue-density. Furthermore, the establishment of preferential trade areas (PTAs) undermined the objectives of the MFN clause and threatened to take the regime back to the interwar period's discriminatory dominant strategy.[116] All of these elements contributed to the institutionalization[117] of the GATT regime into the WTO.

Transaction costs theory is also instrumental in helping to understand this "institutionalization."[118] Asset specificity and bounded rationality/opportunism are the driving force of the creation of organizations.[119] Absent asset specificity, discrete or relational contracting may well deal with the need of parties to

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[115] As David W. Leebron recalls it: "the GATT originated in a context that abjured linkage, albeit on a temporary basis. As an interim agreement that was eventually to be incorporated in the umbrella International Trade Organization, the GATT was to include only issues necessary to tariff negotiations and bindings. Thus, most of the linked or related issues addressed by the ITO Charter, such as commodity agreements, competition policy, and aspects of economic development and investment, were omitted from the GATT." David W. Leebron, *The Boundaries of the WTO: Linkages*, 96 AM. J. INT'L L. 5, 9 (2002).

[116] HUDEC, GATT LEGAL SYSTEM, *supra* note 2, at 6.

[117] Of course, the GATT's contracting parties preferred to address the "sanctioning problems" with "institutionalization" rather than "decomposition" (*see supra* note 102 and accompanying text), because the latter would undermine the goals of expanding freer trade. **R**

[118] *See generally* Kenneth W. Abbott & Duncan Snidal, *Why States Act Through Formal International Organizations*, 42 J. CONFLICT RESOL. 3, 9, 15 (1998). For a comparative approach on the theory of firm and the theory of international organizations, see Joel P. Trachtman, *The Theory of the Firm and the Theory of the International Economic Organization: Toward Comparative Institutional Analysis*, 17 NW. J. INT'L L. & BUS. 470 (1997).

[119] "To be sure, asset specificity only takes on importance in conjunction with bounded rationality/opportunism and in the presence of uncertainty. It is nonetheless true that asset specificity is the big locomotive to which transaction cost economies owes much of its predictive content. Absent this condition, the world of contract is vastly simplified; enter asset specificity, and nonstandard contracting practices quickly appear." OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 47 (1985).

regulate their relationships.[120] Since its conception, the GATT resembled a "relational contracting" structure, which is generally used in relationships that tend to last in the long run (shadow of the future) and where the number of players and/or the number of exchanges tend to be higher than lower. The intensification of asset specificity, however, gave rise to the need to form an "organization." Indeed, "[s]pecialized governance structures are more sensitively attuned to the governance needs of nonstandard transactions [asset specific] than are unspecialized structures, *ceteris paribus*."[121] What, then, is the asset specificity in the WTO/GATT regime?

(a) Asset Specificity – Issue-Density.

Two subcategories of asset specificity are present in the WTO/GATT regime. The first is *team-specificity*[122] (or "*dedicated asset specificity*," under the classic classification[123]), under which an asset has a greater value in its current team use than its value

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[120] CHARLES R.T. O'KELLEY & ROBERT B. THOMPSOM, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS – CASES AND MATERIALS 9–11 (3d ed. 1999).

> In *discrete contracting*, the parties have no preexisting obligations to each other. As they approach a contemplated venture, they negotiate a contract that anticipates and provides a rule governing all contingencies. Nothing is left to be worked out in the future. . . . Discrete contracting is most likely to be successful when the team's expected duration is short and the number of exchanges between team members will be few. *Relational contracting* is a response to the defects of discrete contracting. In relational contracting, parties do not attempt to provide an answer to all contingencies at the time the relation commences. Instead, they attempt to build a governance structure that will allow them to solve problems when, and if, they arise. The goal of relational contracting is to reinforce the relation itself. The hope is that cooperation and harmony will become ingrained norms of the relationship, and that the parties will continue to deal with each other in good faith even when facing difficult adjustment problems.

Id. at 9–11.

[121] WILLIAMSON, *supra* note 119, at 60.

[122] O'KELLEY & THOMPSOM, *supra* note 120, at 7–8.

[123] It seems that this is the subcategory of asset specificity that most resembles those related to international trade relations. Dedicated assets are "the type of specific asset that is placed at hazard by unilateral long-term trade, but which a reciprocal long-term exchange agreement serves to protect. . . Recall that dedicated assets were described as discrete additions to generalized capacity that would be put in place, but for the prospect of selling a large amount of product to a particular customer." WILLIAMSON, *supra* note 119, at 194. WTO Members make investments in dedicated assets when making concessions and commitments, on the

in its next best use.[124] By the time of the Uruguay Round negotiations, trading with GATT contracting parties made a contracting party better off than trading with partners outside the system. The presumed lower levels of tariffs under the system and the number of participants of the system at that time would make trading outside the system more inefficient (lack of efficient next best substitutes).

The second type of asset specificity in the WTO/GATT regime is *issue-density*. There is an underlying similarity between the concepts of *asset specificity* and *issue-density*. Issue density refers to "the number and importance of issues arising within a given policy space."[125] The number of issue-areas covered under the WTO/GATT grew considerably as the result of the Uruguay Round (and of the Tokyo Round) negotiations. In both contexts contracting parties were experiencing "lock in" effects, as Williamson puts it, contributing to the formation of an organization.[126] The introduction of the *single undertaking* clause to deal with the "free-rider" problem of having parties making reservations over certain agreements increased these lock-in effect, and thus paved the way to institutionalization.

(b) Bounded Rationality/Opportunism.

Another impetus for institutionalization was the need to curb opportunism (and its other facet, bounded rationality). Opportunism ("self-interest seeking with guile"[127]) is one of the elements that influences the structuring or the intensification of ties in a contracting setting. In incomplete contracts (such as the GATT), much is left for the future (*ex post* safeguards), since it is not possible for the parties to foresee all potential situations stemming from their relationship (bounded rationality). In such a

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hope of making future business across countries. This may not be a perfect analogy but it is still suggestive. Keohane's *issue density* concept complements this analogy of the WTO/GATT regime with a firm.

[124] O'KELLEY & THOMPSOM, *supra* note 120, at 7–8.

[125] Keohane, *Demand*, *supra* note 101, at 155.

[126] WILLIAMSON, *supra* note 119, at 53 ("Transactions that are supported by investments in durable, transaction-specific assets experience 'lock-in' effects, on which account autonomous trading will commonly be supplanted by unified ownership. . .").

[127] *Id.* at 47.

setting, opportunism *ex post* needs to be refrained *ex ante* by means of credible safeguards for the benefit of the organization.[128] Williamson puts an emphasis on the *ex ante* establishment of *ex post* safeguards in order to make the organizational form viable.[129]

As mentioned above, there was a perception that *ex post* opportunism (or defection, or law-violation) prevailed during the 1970s and 1980s, because of the free-rider problem and the lack of observance of GATT rules. It was therefore necessary to make dispute settlement more "legalized",[130] because there were sufficient conditions for opportunism to appear, thus raising "serious contractual difficulties."[131] Indeed, both the ambiguity of the law and the lack of effective instruments to deter defection (*ex post* safeguards) contributed to this problem. The establishment of a non-stop dispute settlement procedure and an Appellate Body was intended to deal with that. Thus, given the presence of all three requisites (asset specificity, opportunism and bounded rationality), it served the Contracting Parties better to establish an

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[128] WILLIAMSON, *supra* note 119, at 48.

[129] "High-minded" organizational forms—those which presume trustworthiness, hence are based on nonopportunistic principle—are thus rendered nonviable by the intrusion of unscreened and unpenalized opportunists." WILLIAMSON, *supra* note 119, at 65.

[130] When analyzing the *DISC* case, Hudec submits that the "impressionistic technique" often used in dispute settlement procedures in the beginning of the GATT – when consensus ruled – was not proper anymore for the "contentious environment" that gained momentum during the 1980s, because complained parties opportunistically played with the vague language of panels' reports. Robert E. Hudec, *Reforming GATT Adjudication Procedures: The Lessons of the DISC Case*, 72 MINN. L. REV. 1443, 1471 (1988) [hereinafter Hudec, *DISC Case*]. He cites as example the then sugar export subsidies cases Australia and Brazil brought against the EC, in which the EC resisted to implement the unfavorable rulings condemning such subsidies. *Id.* at 1471 n.91.

[131] WILLIAMSON, *supra* note 119, at 67.

> Suffice it to observe here that four cases must be distinguished and that contracting problems vanish for three of them. These are (1) unbounded rationality/nonopportunism – a condition of contractual utopia; (2) unbounded rationality/opportunism – a case where contracts can be made to work well by recourse to comprehensive contracting; (3) bounded rationality/nonopportunism – where contracting works well because of general clause protection against the hazards of contractual incompleteness; and (4) bounded rationality/opportunism – which I maintain accords with reality and is where all of the difficult contracting issues reside.
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> *Id*.

organization (or institution) than to maintain a relational contracting structure.

As far as the argument goes, the changes to the WTO/GATT regime in recent past years led to the creation of an international regime in the international trade realm and ultimately justified the institutionalization of the GATT. But, one issue still remains to be answered: to what extent do these changes require an improvement in the WTO/GATT DS towards a more collective approach?

To answer this question, we must distinguish between "changes *of* regime," "changes *within* a regime" and "*weakening* of a regime," because each species of "changes" generates different effects in the overall structure of an international regime.[132] Changes in the regime's "principles and norms" provoke a change *of* regime.[133] Changes in "rules and decision-making procedures" are changes *within* regimes, "provided that principles and norms are unaltered." *Weakening* of a regime "involves incoherence among the components of the regime or inconsistency between the regime and related behavior."[134]

(v) Changes of Regime.

The original "principles and norms" of the GATT regime (or, interchangeably, Hart's "primary rules") have not been changed, because the *embedded liberalism* remains.[135] However, the domain of the GATT regime was expanded in that other "primary rules" were incorporated in it, especially those reflected in the GATS and the TRIPS. Many provisions of the GATS and the TRIPS have a different scope than the original GATT, which focused on the elimination of barriers to trade in what has been conventionally defined as a "negative integration." The GATS and TRIPS—along with other agreements such as the *Agreement On Trade-Related Investment Measures* (TRIMS)—compelled WTO Members to conform their national legislation with WTO rules (a process of "internalization"), corresponding to a "positive integration." It

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[132] Krasner, *supra* note 96, at 3–5.

[133] *Id.*

[134] *Id.*

[135] *See supra* note 74 and accompanying text. **R**

seems that "positive integration" resembles the provision of "collective goods" while curbing trade barriers resembles the opposition to "collective bads." But, it is more difficult to provide "collective goods" than it is to curb "collective bads."

(a) A Collective Action Digression.

International regimes have also been analyzed from a collective action perspective,[136] particularly with respect to the problem of the provision of collective goods,[137] by means of small individual contributions of all members of a community. In such circumstances, the controlling strategy for each member becomes not to provide its small contribution for the collective good, leading to the underproduction or the non-production of the collective good, "despite the fact that its value to the group is greater than its costs."[138] This strategy (or behavior) is dominant in *latent*

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[136] Stein explicitly examined the GATT regime under a collective action perspective:

> Collective goods issues are not the only problems characterized by prisoners' dilemma preferences for which international regimes can provide a solution. The attempt to create an international trade regime after World War II was, for example, a reaction to the results of the beggar-thy-neighbor policies of the depression years. All nations would be wealthier in a world that allows goods to move unfettered across national borders. Yet any single nation, or group of nations, could improve its position by cheating—erecting trade barriers and restricting imports. The state's position remains improved only as long as other nations do not respond in kind. Such a response is, however, the natural course for those other nations. When all nations pursue their dominant strategies and erect trade barriers, however, they can engender the collapse of international trade and depress all national incomes. That is what happened in the 1930s, and what nations wanted to avoid after World War II.

Stein, *supra* note 99, at 124.

[137] Hardin explains that public goods are defined by two properties, namely, *jointness of supply* ("one person's consumption of it does not reduce the amount available to anyone else") and *impossibility of exclusion* ("it is impossible to prevent relevant people from consuming it"). Because it is difficult to find situations where both properties are met, Hardin adopts the broad term collective (or group) goods. He further explains that finer distinctions between this concept and that of private consumption goods and of shared goods are unnecessary for the understanding of the collective action theory. RUSSEL HARDIN, COLLECTIVE ACTION 17–19 (1982).

[138] KEOHANE, HEGEMONY, *supra* note 100, at 69 (citing MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1965); HARDIN, *supra* note 137, at 17–19).

groups, where the net gains from cooperation are small.[139] The latent groups are likely to fail, unless modified.[140]

The collective action problem is understood as another reading of the "problem of the back of the [Adam Smith's] invisible hand,"[141] along with the standpoints of the Prisoners' Dilemma, the "free rider problem," or the condition of common fate, depending on the context or discipline under which it is examined.[142] In relation to the Prisoners' Dilemma, Hardin demonstrates that both approaches are "essentially the same,"[143] except that in the collective action problem the players are, on one side, an individual and, on the other side, a group having as its common interest the provision of a collective good. The failure of the group to contribute for the provision of the collective good leads either to a proportional decrease in the total benefits or to a proportional increase in the cost that the members of the group incur.[144] In this setting, an individual will be better off not paying its contribution towards the purchase of the collective good (the same strategy under a Prisoners' Dilemma game).[145] Thus, the conclusions related to the perspectives of success of cooperation (or collective action) in an iterated Prisoners' Dilemma hold here too:[146] cooperation becomes less likely to occur

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[139] OLSON, *supra* note 138, at 23, 49–50, formalizes as follows: *Ai* (net benefits of individual *i*) = *Vi* (gross benefits of individual *i*) – *C* (costs). If *Ai* > 0 for some *i*, the group is *privileged* (and the group will succeed). If *Ai* < 0 for *all i*, the group is *latent* "unless other non-collective-good (selective) incentives are available to induce contribution." *Id.*

[140] Hardin mentions three considerations that may modify a latent group: (i) political entrepreneurship, (ii) the selective incentives (including solidary incentives) of the by-product theory, (iii) and extra-rational behavior. HARDIN, *supra* note 137, at 22.

[141] *Id.* at 6.

[142] *Id.* at 7.

[143] They are analogous provided "one's contribution to the purchase of the collective good is of only marginal utility to oneself." *Id.* at 28.

[144] *Id.* at 26, presents the matrix as follows:

	Individual	Collective
	Pay	Not Pay
Pay	1,1	–0.8, 0.2
Not Pay	1.8,0.8	0,0

[145] *Id.* at 25–30.

[146] *Id.* at 28.

as the number of players (n) increases in iterated plays or, in other words, "the logic of collective action militates against cooperation in large enough groups."[147] Nevertheless, the dominant equilibrium strategy yields a poor payoff for all players, which is Pareto-suboptimal because some (if not all) could be better off without being made any others worse off.[148] To sum up, the problem of collective action is "how to get someone to be orderly—when it is in his or her self-interest not to be."[149]

The literature of collective action resolves this problem by the establishment of "contract by convention."[150] These contracts "can produce a high level of cooperation even in relatively large groups," where cooperation is more likely to fail.[151] These contracts change the payoff structure of each player and therefore facilitate cooperation. This is not novel, because these contracts are equivalent to the regime theory's "norms, rules and decision-making procedures" (or "international law") or to the transaction costs theory's relational contracting (being subject thus to the formation of institutions where the necessary conditions are met).

The problem, of course, lies in the enforceability of these contracts.[152] In coordination settings, mere behavioral inputs may suffice to induce compliance, but in cooperative ones, where the application of sanctions is one of the available enforcement techniques, such inputs are not sufficient. The collective action literature appears to suggest that sanctions may be applied either by a central authority (voluntarily accepted by a sufficient number of individuals[153]) or by a sample of individuals "capable of acting collectively," "a group of a critical size which can act, and act

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[147] *Id.* at 13, 29.

[148] *Id.* at 27–28.

[149] HARDIN, *supra* note 137, at 169.

[150] *Id.* at 170. Hardin shows that collective good problem differ from coordination problems, where parties achieve a Pareto-optimal result through tacit conventions. *See also generally* Snidal, *Coordination*, *supra* note 52.

[151] HARDIN, *supra* note 137, at 13, 38–49.

[152] *Id.* at 172.

[153] HART, *supra* note 19, at 201, *cited in* HARDIN, *supra* note 137, at 177.

> It is true, as we have already emphasized in discussing the need for and the possibility of sanctions, that if a system of rules is to be imposed by force

continuously."[154] Individuals may lack the incentives to apply individual sanctions for fear of others' threat credibility.[155] Knowledge is also important to enable individuals to know the other individuals' behavior, interests and threat credibility.[156]

Whether in the form of "delegation of power" or in the form of "amalgamation of power," the taking of action *by a group* is suggestive and supports the central proposition of this paper. Indeed, the application of individual sanctions against a nonconformer (the free-rider) in a collective action situation generally takes place as follows: the player applying the individual sanction withdraws its contributions to the provision of the collective good. The negative impact of this (total or partial) withdrawal is self-evident, because it will make the total amount of contributions to the provision of the collective good smaller.

(b) "Positive Integration" and the Problem of the Provision of Collective Goods.

It is more difficult to provide "collective goods" than to curb "collective bads." There are numerous reasons for this.[157] The

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on any, there must be a sufficient number who accept it voluntarily. Without their voluntary co-operation, thus creating *authority*, the coercive power of law and government cannot be established.

Id.

[154] This idea is neither clearly nor expressly developed under Hardin's account, based on PETER LASLETT, THE FACE TO FACE SOCIETY 160 (1956). It is not clear whether under the "collective action" solution the taking of action by the group would take the form of sanctions in the strict sense (such as under a central authority) or of "reputational costs" (consider, for instance, the explanation that under Laslett proposal, such collective action would work in a face-to-face society, where "everyone in it *knows* everyone else in it. . ."). HARDIN, *supra* note 137, at 184. Compare Hardin's explanation relating to the effects of overlapping activities over reputation: "Overlapping activities are therefore perhaps most important for their relation to reputation, or rather for the dependence of one's reputation on one's behavior in a cluster of activities." *Id.* at 185.

[155] *Id.* at 183.

[156] This situation is similar to a Prisoner's Dilemma contingent defection. Here, the considerations on the problem of retaliation on iterated Prisoner's Dilemma also apply. *Id.* at 183. *See supra* note 87 and accompanying text. For an N-Person Prisoners' Dilemma situation, Hardin suggests decomposition of the large group in smaller ones. *Id.* at 184. **R**

[157] The taking of action against collective bads is generally easier because: (i) the tasks are generally clearer; (ii) the costs of action are lower; (iii) people who would not engage in the provision of collective goods may nevertheless engage to

most relevant reason for the purpose of this paper is the fact that action against collective bads may take the form of *less expensive* forms of "regulation."

For instance, under the WTO/GATT regime, the provision of collective goods requires the establishment of more effective and constant systems of monitoring, reporting, capacity building and dispute settlement (to clarify ambiguity). The TRIPS framework encompasses all of these elements, but the internalization of norms shaping intellectual property protection is far from complete. Furthermore, the improvement of the Trade Policy Review Body (TPRB), under the *Trade Policy Review Mechanism* (TPRM), represents an attempt to deal with the informational imperfections problem, by means of establishing voluntary reporting of WTO Members' trade practices (Paragraph D) and *ex officio* gathering of information by the TPRB (Paragraph C(v)(b)), in order to provide WTO Members with more information about the other Members' trade behavior.

These elements together support the idea that a significant change *of* the WTO regime has already taken place, *i.e.*, from a relational contracting structure (bilateral) to an organizational one (collective action). However, the WTO DS enforcement system still reflects the "old" GATT relational contracting structure. Under relational contracting frameworks, parties being separate entities are likely to view issues from a self-interested (or individualistic) perspective. This is clearly reflected in the structure of Article XXIII of the GATT where focus is given to the restoring of the balancing of concessions, rather than to the impact that opportunistic behavior may cause on the overall relationship of the parties.

An analogy to the collective action problem becomes evident at this point. Under the GATT system, the application of sanctions leads to Viner's trade diversion[158] to the detriment of free trade (*the* collective good). Thus, the establishment of a regime where members must provide for the provision of collective goods suggests that a collective action system of sanctions is also

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curb collective bads; (iv) many people play fair (contractarians); (vi) "losses are often apparently felt more acutely than gains of comparable magnitude." *Id.* at 62–64.

[158] For considerations on trade diversion, see generally JAGDISH BHAGWATI, FREE TRADE TODAY 107–11 (2002).

required. Chapter VI addresses whether this system should take the form of a "delegation of power" or of an "amalgamation of power."

(vi) Changes within the WTO/GATT Regime.

The "rules and decision-making procedures" (or Hart's "secondary rules") of the GATT regime have also been subject to an "evolutionary change."[159] Regarding dispute settlement, the major change within the WTO/GATT regime was the shift from a "power-oriented" to a "rules-oriented" system[160] (unilateral threats have been explicitly outlawed, under Article 23, DSU[161]). This was part of a "big bargain" between the WTO Members, which added intellectual property and trade in services in the WTO regime as part of the bargain.

Indeed, the restriction on the usage of Section 301 is a *hostage* in the sense of Williamson's "credible commitments."[162] "Credible threats" and "credible commitments" are alternative forms of enforcement of obligations, the former used in conflict and rivalry situations and the latter in support of alliances and to promote exchange.[163] Techniques, such as the use of *hostages*, are used as *ex ante* safeguards of contracts to support exchange. They

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[159] Krasner, *supra* note 96, at 20.

[160] *See* JOHN H. JACKSON, WORLD TRADE SYSTEM 109–11 (1997).

[161] Interestingly, few years before the end of the Uruguay Round negotiations, Hudec precisely depicted the momentum when U.S. officials would consider the possibility of making such a package deal.

> Congress would be willing to consider compliance legislation, and other troublesome policy changes, if they are packaged together with all the other concessions the United States will be making for benefits received in the Uruguay Round, and if they are buried in nonamendable 'fast-track' legislation that immunizes legislators from special interest groups.

Hudec, *Section 301*, *supra* note 45, at 150.

[162] WILLIAMSON, *supra* note 119, at 167–68.

[163] Usually, little attention is devoted to "credible commitments" because in a domestic context there is a presumption that "legal system enforces promises in a knowledgeable, sophisticated, and low-cost way." *Id.* at 167–68, 203–05. Williamson, however, admonishes that alternative bilateral (negotiation) and trilateral (mediation and arbitration) forms of dispute resolution evidence the contrary.

generally appear in situations where parties devote efforts in order to develop specific assets. In these situations, "complex governance structures. . . arise in response to such conditions."[164]

This expressive change within the WTO regime suggests that a portion of the balance of the "big bargain" rests on the ability of the WTO DS to develop effective means to bring WTO Members to comply with WTO rules. If the multilateral system were to fail, a return to a system of unilateral threats would undermine the commitment achieved in the negotiations and put cooperation under the regime at risk. Accordingly, this conclusion also supports the general thesis of this paper that there is a need to improve the WTO DS as a multilateral/collective action system of enforcement.

(vii) Weakening of the Regime.

It is self-evident that a "weakening" of the GATT regime had occurred during the past sixty years. The regime used to focus considerably on reputational costs[165] as the major incentive to make GATT Contracting Parties conform to prescribed standards of behavior. This focus proved insufficient for the GATT regime,[166]

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[164] *Id.* at 204.

[165] KEOHANE, HEGEMONY, *supra* note 100, at 106.

[166] Mavroidis, *supra* note 10, at 810–11.

> [T]he problem with all these explanations is that a good counter-argument always exists: reputation costs, for example, can easily play second fiddle to other interests; we can even very well imagine situations where inconsistencies can be explained without the reputation of the inconsistent member suffering at all (essentially by pointing to the uniqueness of a dispute). Moreover, it is certainly factually inaccurate to state that the WTO contract corresponds to everyone's idea of justice: it is hard to explain the ever-rising number of disputes otherwise. (footnote omitted) And it is also factually incorrect to argue that each and every WTO member has important vested interests in other fields and hence the WTO contract must always be respected because of them. All these grounds thus advanced have indeed helped our understanding with respect to compliance with (international) obligations. But they all refer to *individual* reasons why a contract is respected. Hence, compliance for the reasons mentioned depends on subjective grounds. However, legal security (transaction costs) aims at preserving a situation where the contract will under all circumstances be observed, independently of individual grounds for respecting it. In other words, for legal security to be served, *institutional* rather than individual grounds must be agreed and inserted in the contract that will guarantee respect at all times.
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> *Id.*

and will be addressed in the discussion below of whether a managerial model is complementary or alternative to a coercive model of enforcement.

3. A Few Words About the Benefits of Using International Organizations for Dispute Settlement Purposes

From a constructivist[167] view, the use of international organizations can be instrumental in achieving goals in addition to minimization of transaction costs. The effects of *centralization* and *independence* play a significant role when states decide to engage in the formation of international institutions and are generally the determinative variables of the institution's design.[168] Some of the benefits of institutional *centralization* were already discussed above, including the provision of support for participant states' interaction and serving as a tool for managing substantive operations (economies of scale through *pooling*), joint production (team-work) and norm elaboration and coordination.[169]

The *independence* of the international organizations may also be relevant to the enforcement of dispute settlement decisions and could be instrumental if a multilateral system of enforcement is implemented in the WTO regime. As Abbott and Snidal put it, "the participation of an IO [international organization] as an independent, neutral actor can transform relations among states, enhancing the efficiency and legitimacy of collective and individual actors."[170] Indeed, the greater the degree of independence of an institution, the greater the legitimacy the decisions of that institution.[171] Unilateral actions that could be seen as unfair or unreasonable can become legitimate actions, in a sort of *laundering* effect.[172] This effect may diminish the effect that unilateral retaliations –absent the WTO/GATT regime— would provoke. The *neutrality* of the decisions of the WTO's adjudicating

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[167] Abbott & Snidal, *supra* note 118, at 8.

[168] *Id.* at 4.

[169] *Id.* at 10–16.

[170] *Id.* at 16.

[171] *Id.* at 4.

[172] *Id.* at 18.

bodies also helps making these retaliatory actions more palatable, for reasons of "limited provocability" and for the two-level game problem, *e.g.*, by giving government leaders an excuse (or someone to blame on) when communicating to constituencies that some benefits will be curtailed. Thus, "such managerial activities counteract 'echo effects' and are improvements over strictly decentralized enforcement."[173]

4. Considerations on a Contract Theory Perspective

Some literature has addressed the issue of enforcing DSB's recommendations under a contract theory approach. There are two main arguments. The first one relates to the "bindingness"[174] of WTO rules, *i.e.*, whether WTO Members are obliged to follow them or whether there would be a "way-out" to (or an "efficient breach" of) such obligations. The second argument—which is intimately related to the first one—refers to the level of retaliation that ought to be authorized in case a party to a dispute fails to comply with the WTO adjudicating bodies' recommendations.

(i) The "Bindingness" Problem of WTO Rules - The "Efficient Breach" Argument.

Professor Jackson rejects the first argument,[175] listing eleven provisions of the DSU[176] to support the argument that WTO rules[177] are binding in the sense that WTO Members must comply with them.[178] He acknowledges the lack of an explicit provision in that sense. He also concedes that the lesser degree of enforcement inherent to international law may give the idea that such rules

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[173] *Id.* at 27.

[174] Expression used by John H. Jackson, *The WTO Dispute Settlement Understanding – Misunderstandings on the Nature of Legal Obligations*, 91 AM. J. INT'L L. 60, 64 (1997) [hereinafter Jackson, *Misunderstandings*].

[175] The argument was made by Judith Hippler Bello, *The WTO Dispute Settlement Understanding: Less is More*, 90 AM. J. INT'L L. 416 (1996).

[176] They are as follows: Article 3:4, 3:5, 3:7, 11, 19:1, 21:1, 22:1, 22:2, 22:8, 26:1(b). Jackson, *Misunderstandings*, *supra* note 174, at 63 n.11.

[177] *Id.* at 63. Professor Jackson uses the expression "WTO rules" interchangeably with the expression "WTO adjudicating bodies' recommendations."

[178] *Id.* at 63–64. *See also* Mavroidis, *supra* note 10, at 782–83; Pauwelyn, *supra* note 9, at 340 n.32. For arguments and counter-arguments, see RAJ BHALA, INTERNATIONAL TRADE LAW: CASES AND MATERIALS 240–42 (1996).

are not binding to the extent known in a domestic law context. Sykes challenges Jackson's legal arguments, presenting alternative interpretations to the provisions to which Jackson referred.[179] Offering arguments from a WTO law perspective and a general international law and policy perspective, Palmeter and Alexandrov support the Holmesian "perform or pay" approach towards contractual obligations. However, the main focus of their paper is the interpretation of the term "appropriate" under Article 4.11 of the *SCM Agreement*, which they submit should not be read independent of the harm inflicted to the complaining party and having as its sole purpose to "induce compliance."[180]

(a) The Objective of Countermeasures.

None of the papers discussed above contain any reference to Article 22.3 of the DSU. This article provides for the possibility that a complaining Member may impose retaliation in sectors other than that subject to the WTO adjudicating bodies' reports ("cross-retaliation"), where the complaining Member considers that a "horizontal retaliation" is not "practicable or effective" (Article 22.3(b)). Cross-retaliation may also take place under other agreements, provided the "practicability or effectiveness"

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[179] Sykes draws an analogy of the WTO DS to a private contract. Where specific performance is available courts would make use of all measures at its disposal seeking to induce compliance (imprisonment, punitive damages and the like). Where specific performance is not available, the defecting party would choose to pay expectation damages (in a view to reestablish the *status quo ante*) instead of performing the obligation. In this circumstance, the court would then devote more time and efforts seeking to value the harm, rather than to undertake measures seeking to induce compliance. Sykes then submits that the WTO DS system seems to allow expectation damages-like remedies since Article 22.4 of the DSU establishes that "[t]he level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment." If compliance was the ultimate and unique goal of the WTO DS, he says, thus the level of retaliation should be that of the benefit of the violation from the violator and not the harm the complaining party suffered with the violation. Alan O. Sykes, *The Remedy for Breach of Obligations under the WTO Dispute Settlement Understanding: Damages or Specific Performance?*, *in* NEW DIRECTIONS IN INTERNATIONAL ECONOMIC LAW – ESSAYS IN HONOUR OF JOHN H. JACKSON 347, 347–57 (Marco Bronkers & Reinhard Quick eds., 2000) [hereinafter Sykes, *Remedy*].

[180] David Palmeter & Stanimir Alexandrov, *"Inducing Compliance" in WTO Dispute Settlement*, *in* THE POLITICAL ECONOMY OF INTERNATIONAL TRADE LAW: ESSAYS IN HONOUR OF ROBERT E. HUDEC 646 (Daniel L.M. Kennedy & James D. Southwick eds., 2002).

test is met and the "circumstances are serious enough" (Article 22.3(c)). The use of those two words in this standard appears to focus on two problems: (i) the eventual negative impacts the complaining Member may face in raising tariffs of a specific complained Member's product, and (ii) the need to make retaliation an "effective" means of inducing compliance.

The dictionary[181] shows that "effective" means "powerful in effect," "making a strong impression" and "having an effect or result." Accordingly, Article 22 of the DSU may also be interpreted so as to achieving the purpose for which it was designed, *i.e.*, to increase the level of incentives for the defending Member to comply with the WTO rules (or simply "inducing compliance"[182]).

This interpretation is highly controversial. Sykes, Bello, Palmeter & Alexandrov object to this view, contending that the purposes of countermeasure is limited to restoring the balance of concessions—and nothing else. However, the use of the word "effective" in Article 22.3(b) and (c) seems to add a *qualitative* dimension to the level of countermeasures that a complaining Member may take. In the pre-WTO era, the analysis of the countermeasures was generally limited to the quantitative dimension. The introduction of Article 22.3(b) and (c), as explained below, amounts to a remarkable change in the WTO/GATT DS.

(b) The Two Dimensions of Countermeasures.

Consider the historical and comparative account of the use and interpretation of the provisions relating to countermeasures

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[181] THE NEW SHORTER OXFORD ENGLISH DICTIONARY 786 (4th ed. 1993) [hereinafter OXFORD ENGLISH DICTIONARY], dictionary used in the *EC – Bananas – Ecuador (Article 22.6 – EC)* case, *see supra* note 35, to assess the first interpretative criteria of Article 31.1 of the Vienna Convention on the Law of Treaties, May 22, 1969, 1155 U.N.T.S. 331.

[182] The expression "induce compliance" has been generally interpreted in different ways. Sykes uses it almost as a synonym for the remedy applied to cases where specific performance is required. Sykes, *Remedy*, *supra* note 179, at 351. Palmeter & Alexandrov uses it as tantamount to the setting of "stiffer penalties" against the defecting party. Palmeter & Alexandrov, *supra* note 180, at 660. *See also* Mavroidis, *supra* note 10, at 809–12. The definition used here encompasses a broader sense, from the Chayeses managerial regime "jawboning" process (CHAYES & CHAYES, *supra* note 26, at 22) to other instruments available to make the WTO DS system effective (coercive measures). These are all different degrees of a single broad concept.

in Article XXIII.2 of the GATT, on one hand, and Articles XIX (safeguards) and XXVIII (modification of schedules) on the other.[183] Article XXIII allowed the CONTRACTING PARTIES to authorize the application of countermeasures as "appropriate in the circumstances." Under Articles XIX and XXVIII, retaliation referring to the suspension of concessions or obligations was to be made in a "substantially equivalent" manner.[184] Therefore, Article XXIII theoretically authorizes suspension of obligations in a broader extent than Articles XIX and XXVIII.[185]

The *U.S. Dairy Products* case is generally cited to support the view that Article XXIII's use of the word "appropriate" should be read as "equivalent" to the impairment suffered by the Netherlands as a result of the U.S. restrictions. At that time, some contracting parties challenged the ability of the Working Party to reduce the Dutch retaliation level, taking into consideration a precedent where the panel decided that the opposing party carries the burden to prove the complaint.[186] To dissuade this opposition, the Chairman of the Working Party made a statement in the following Session asserting that "the word 'appropriate' in Article XXIII meant more than just 'reasonable'; it required the Working Party to take into account 'the desirability of *limiting* such action to the best calculated in the circumstances to achieve the objective.'"[187]

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[183] Palmeter & Alexandrov, *supra* note 180, at 646–51. *Cf.* Mavroidis, *supra* note 10, at 800–01.

[184] General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, arts. XIX 3(a), XXVIII.3(a), LEGAL INSTRUMENTS–RESULTS OF THE URUGUAY ROUND 23, 33 I.L.M. 1125 (1994) [hereinafter GATT].

[185] *See* the often quoted 1988 statement of the Legal Adviser to the GATT Director-General: "In the case of Article XXIII, the wording was wider, referring to measures determined to be appropriate in the circumstances, which meant that there was a wider leeway in calculating the retaliatory measures under Article XXIII than under Articles XIX or XXVIII." GATT Doc. C/M/220, at 35, *quoted in* WORLD TRADE ORGANIZATION, 2 ANALYTICAL INDEX: GUIDE TO GATT LAW AND PRACTICE 698 (1995).

[186] *U.S. Escape Clause Action on Fur Felt Hat Bodies*, CP.5/22 (Nov. 7, 1950). The U.S. claimed that this case was altogether different from the *U.S. Dairy Products* case, because it was based on Article XIX of the GATT (escape clause) and therefore not applicable.

[187] HUDEC, GATT LEGAL SYSTEM, *supra* note 2, at 196; Sr. 7/17 (Nov. 8, 1952), at 1.

It seems that the rationale for this statement was simply to indicate the need for outcomes suitably tailored (in both *quantitatively* and *qualitatively* dimensions) to provide solutions. It was not the intention of the Chairman to establish a system of automatic reduction of requests for authorization.[188] Moreover, CONTRACTING PARTIES would still theoretically be able to impose what Jackson called "serious sanctions."[189] In fact, there is generally an emphasis on the *quantitative* aspect of Article XXIII.[190] However, nothing in the text of the GATT explicitly allows this narrow interpretation.

Moreover, it is interesting to note that the Chairman's (Dr. True's) statement, in an often overlooked text, makes it clear that the real objective of the countermeasures authorized in the *U.S. Dairy Products* case was to induce the United States to comply with its GATT obligations (by means of the removal of the complained measure). Thus, it was not merely aimed at restoring the balance of concession: "He [Dr. True from Austria] explained that his statement in the morning meeting had meant to make clear that the Working Party's choice of the lower figure had rested on its opinion that the lower figure would better *achieve the real objective, removal of the U.S. measure*." (Emphasis added.)

Article 22.4 of the DSU, in turn, explicitly provides that countermeasures "shall be equivalent to the level of the nullification or impairment." The word "equivalent" is of course more restrictive than Article XIII's "appropriate." The language of this article makes it clear that it regulates the *quantitative* aspect of the

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[188] The complaining party can always request authorization to apply retaliation in a level lower than the maximum amount of retaliation. Thus, an automatic limitation on the level of retaliation would not theoretically take place in those cases.

[189] Palmeter & Alexandrov, *supra* note 180, at 646–49, makes reference to Jackson's point that this "language is not limited just to 'compensating' redress but is broad enough to be used as the basis for serious actions. For instance, all concessions of all other contracting parties could be suspended *vis-à-vis* a notoriously offending contracting party—in effect, driving it out of the GATT—if the CONTRACTING PARTIES determined this to be 'appropriate.'" JOHN H. JACKSON, WORLD TRADE AND THE LAW OF THE GATT § 8.5 (1969).

[190] Hudec clearly emphasizes the quantitative dimension of such a word. HUDEC, GATT LEGAL SYSTEM, *supra* note 2, at 196.

countermeasures (as it is directly related to the level of nullification and impairment). The *qualitative* aspect of the countermeasures is regulated under Article 22.3, especially (c) and (d). Thus, in light of this interpretation of Article XXIII, the explicit bifurcation of the purpose of countermeasures in Article 22.3 of the DSU is consistent with GATT's legal text.

Even if, *arguendo*, there was no qualitative dimension in the countermeasures authorized under Article XXIII of the GATT, the introduction of this element in the DSU must have some meaning. In fact, why would the WTO Members introduce language in Article 22.3 (c) and (d) to the effect that countermeasures should be "effective" if the quantitative dimension was already covered under Article 22.4? Because the quantitative dimension of the countermeasures is directed at restoring the balance of concessions while their qualitative dimension at inducing compliance.[191] The contrary does not render *effet utile* to Article 22.3(b) and (c). Thus, if one of the objectives of Article 22 of the DSU is to induce the complained Member to comply with WTO rules, then it was the intent of the WTO Members to make sure that the WTO rules are binding.

(c) Economic Considerations – The "Echo Effect."

A Holmesian "perform or pay" system permits the perpetuation of the imbalance of powers. A stronger Member is more likely to be in a position to pay its way out of the DSB's recommendations than the majority of the weaker Members. Issues of fairness aside, "efficient breaches" may be detrimental to the integrity of the WTO DS regime because they may undermine the incentives such a regime provides in enhancing cooperation. Since the world trade system is today an N-person game, violations to the rules may provoke an "echo effect," turning defection into the controlling strategy.

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[191] Interestingly, the Arbitrator in the *Canada – Aircraft* case adopts a line of reasoning confirming the role that the nature of countermeasures (and the sectors under its application (cross-retaliation)) play in inducing compliance: "[t]hat uncertainty exists because, in addition to the level of the countermeasures, the nature of the countermeasures and the sectors subject to countermeasures have a role in determining likely compliance." *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, ¶ 3.48 (Jan. 28, 2002) [hereinafter *Canada – Aircraft*]. Of course, this case relates to export subsidies and therefore cannot be used in direct support for this argumentation.

Sykes submits that for almost sixty years of WTO/GATT system, trade wars have not occurred at a level worth of concern, making the "echo effect" argument unrealistic.[192] However, trade wars are not the only form an "echo effect" may take. The proliferation of bilateral and plurilateral agreements is perhaps the paramount example of that. This proliferation systematically undermines the most-favored-nation and nondiscrimination principles of the WTO/GATT system.[193]

The United States did not pursue the establishment of bilateral and plurilateral agreements until the mid-1980s.[194] There is evidence to indicate that this seems to have been a counter-reaction to the EC's policy of establishing PTAs and to the special and preferential treatment accorded to developing countries. As Bhagwati puts it, "the truly compelling reason these PTAs have proliferated is simply what we economists call the (Nash) pursuit of individual interest in an uncoordinated fashion when there is a superior coordinated pursuit of a better solution. As bilaterals multiply, countries begin to feel that they are being frozen out of markets within those bilaterals.[195] They then begin plotting their own, going with politically pliable partners. So more bilaterals are started. And pretty soon we have the phenomenon we see today: an escalating expansion of bilaterals."[196] And finally:

> [W]e are thus reproducing in the world trade system, in the name of free trade but through free trade areas that spread

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[192] Sykes, *Remedy*, *supra* note 179, at 351.

[193] This paper will not focus on the legal aspects of Article XXIV of the GATT that authorizes the implementation of customs unions and free trade areas. This paper uses Professor Bhagwati's expression "preferential trade areas" (PTAs) instead of "free trade areas" (FTAs). For an account of the trade diversion effects that PTAs bring about and other considerations about PTAs, see JAGDISH BHAGWATI, FREE TRADE TODAY 106–19 (2002).

[194] This first bilateral agreement the U.S. entered into with was executed with Israel (1985), followed by Canada (1988), Jordan (2000), Singapore (2003), Chile (2003), Morocco (2004), Australia (2004), and Central American countries (2004).

[195] "Thus, Business Roundtable, an influential U.S. lobby of businessmen, recently expressed alarm over the U.S. businesses being left out of world's fragmenting markets and asked the U.S. government to pursue more PTAs of its own. Similar alarms have been expressed in India, Australia, and indeed several countries, by their governments and/or their business groups." BHAGWATI, *supra* note 158, at 117 n.26.

[196] *Id.* at 117.

> discrimination against producers in nonmember nations, the chaos that was created in the 1930s through similar uncoordinated pursuit of protectionism that discriminated in favor of domestic producers. In both cases, the preferred solution would have been nondiscriminatory pursuit of freer trade.[197]

The main flaw in analyzing the WTO DS from a contract theory perspective is the failure to take into consideration that WTO Members are immersed in an iterated game. The contract theory perspective also does not consider the impact of an efficient breach over future (or even present) transactions carried out between the same parties. The concept of the WTO/GATT regime as just a "package of bilateral equilibria"[198] ignores the metamorphosis in the WTO/GATT regime in the last sixty years and therefore misses the point.

(ii) The "Stiffer Penalties" Argument.

Some literature advocates the imposition of "stiffer penalties" against WTO Members that fail to comply with DSB' recommendations.[199] The underlying idea is that "stiffer penalties" will induce WTO Members into compliance. The raising of the costs of defection would take place in the form of bilateral enforcement mechanisms (BEMS), since multilateral enforcement mechanisms (MEMS)[200] are not yet allowed under the WTO DS system.[201]

The problem with the idea of applying "stiffer penalties" lies in its focus on the use of BEMS. Raising the level of BEMS in a level higher than the indifference curve of the defecting WTO Member is inefficient in inducing compliance.[202] In this view, the "limited provocability" principle is key to understanding the inefficiency of applying stiffer BEMS to induce compliance. This also supports the case for the introduction of a multilateral system of

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[197] *Id.* at 117.

[198] Pauwelyn, *supra* note 9, at 340.

[199] Marc L. Busch & Eric Reinhardt, *Testing International Trade Law: Empirical Studies of GATT/WTO Dispute Settlement*, THE POLITICAL ECONOMY OF INTERNATIONAL TRADE LAW, *supra* note 180, at 457.

[200] Terms introduced by Maggi, *supra* note 87, at 197.

[201] *See infra* note 265 and accompanying text. **R**

[202] *See infra* note 261 and accompanying text. **R**

enforcement, where MEMS would also play a role in inducing compliance.

5. Managerial Regimes

(i) The Chayeses Proposition.

Abram Chayes and Antonia Handler Chayes (the "Chayeses") provided one of the most comprehensive studies on the issue of the compliance of nations with international obligations. A detailed analysis of their study is essential to evaluate its application to the WTO regime. Most interestingly, the Chayeses' analysis maintains a dialogue with the economic (transaction costs, collective action and game theories) and political science (regimes and institutionalism) literatures revisited above, and serves as a bridge between those studies and the study of law.

The Chayeses dismiss coercive enforcement measures (or treaties with "teeth") as the solution to the compliance puzzle. They describe this as an "incorrect analogy to domestic legal systems."[203] They submit that sanctions are deficient because of their costs and legitimacy. The costs of economic sanctions are high both to the sanctioned and to the sanctioning states. The political costs of imposing sanctions are also high because of "the serious political investment required to mobilize and maintain a concerted military or economic effort over time in a system without any recognized or acknowledged hierarchically superior authority."[204] The Chayeses also contend that because of the political costs, sanctions tend to be applied in an *ad hoc* fashion, leading to problems of legitimacy (as sanctions are neither "systematic [nor] evenhanded"[205]). They also say that sanctions to be effective must have the support of the most powerful states, especially the United States.[206] Therefore, a system where only the weaker countries were compelled to comply with the obligations would also lack legitimacy. The Chayeses propose the adoption of an

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[203] CHAYES & CHAYES, *supra* note 26, at 2.

[204] *Id.*

[205] *Id.* at 3.

[206] *Id.*

alternative model of compliance. Rather than a coercive model, they support a "managerial" one.[207]

The Chayeses build their proposition on the assumption that states will comply with their obligations because (i) it is *efficient* (international rules establish an "authoritative rule system" and are thus transaction costs economizing tools[208]); (ii) it is presumably under the *national interests* of the contracting states (the final result of the treaty will presumably accommodate the interests of the negotiating states and also of the respective domestic constituencies—the "two-level game"[209]); and (iii) *norms* are tools of legitimizing states' actions.[210]

The Chayeses then present three major reasons why countries do not comply with their international obligations. The first reason is *ambiguity* and indeterminacy of treaty language (a legal approach to the problem of bounded rationality *ex ante* and opportunism *ex post*). The second reason is the *limitations on the capacity of parties* to carry out their treaty undertakings. These limitations would be most prevalent when states must contribute to the provision of collective goods (regulatory treaties) and when countries face scientific, technical, bureaucratic and/or financial deficiencies in building regulatory framework (*e.g.*, developing countries). Finally, there is "*the temporal dimension*," *i.e.*, "avoidable and unavoidable time lags between a state's undertaking and its performance."[211]

The Chayeses call attention to the problem of "acceptable levels of compliance," which vary according to the capacity and urgency of parties to an agreement to comply with its provisions. As they explain, "[i]t may depend on the type of treaty, the context, the exact behavior involved," and tends to be complex given the subjectivity of such an assessment.[212] They submit that "the acceptable level of compliance would vary with significance and

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[207] Put into perspective, Koh places the Chayeses work in the International Legal Process School. Koh, *Why Nations Obey*, *supra* note 12, at 2614–25.

[208] CHAYES & CHAYES, *supra* note 26, at 4.

[209] The Chayeses basically reinforce the assumption that states enter into agreements in good faith. *Id.* at 7.

[210] In their words, "[n]orms help define the methods and terms of the continuing international discourse in which states seek to justify their actions." *Id.* at 8.

[211] CHAYES & CHAYES, *supra* note 26, at 9–17.

[212] *Id.* at 17.

cost of the reliance parties place on the others' performance."[213] They provide numerous examples supporting the idea that a strict level of compliance is required in relation to treaties involving national security, although some flexibility on the acceptable level of compliance has been allowed.[214] Economic and environmental treaties would be more tolerant of noncompliance,[215] but up to levels that do not put the system at risk: "defections will not necessarily unravel the treaty if the level of compliance is acceptable."[216]

The Chayeses dismiss the economic approach of raising the costs of defection to induce compliance. They argue that generally it is not possible to quantify or even monetize the relevant factors in the equation, especially because "the process by which preferences are aggregated is necessarily a political one." Thus, where circumstances change, the solution would lie in changes in the acceptable level of compliance rather than in defection.[217] If the acceptable level of compliance is exceeded ("critical-mass phenomenon"), regimes might collapse, either because of the character of a particular violation or of the identity of the violator, thus triggering a demand for higher levels of compliance.[218]

Based on the assumption that states do not willfully disobey international obligations but do it because of the lack of capability, clarity or priority, the Chayeses submit that "coercive enforcement is misguised as it is costly." The alternative managerial model would then comprise: (i) ensuring transparency (for basically the same reasons provided under the Prisoners' Dilemma

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[213] *Id.* at 17–18.

[214] Perhaps because the application of retaliation in an arms control problem could lead to the results of a zero-sum game (a *Chicken* game), *i.e.*, the destruction of both players.

[215] *Id.* at 19 ("Such regimes are in fact relatively forgiving of violations that can be plausibly justified by extenuating circumstances in the foreign or domestic life of the offending state, provided the action does not threaten the survival of the regime.").

[216] *Id.* at 20.

[217] *Id.* at 20.

[218] *Id.* at 21.

situation and collective action problems[219]), by means of self-reporting and verification;[220] (ii) dispute settlement to deal with the problem of ambiguity or vagueness, with the models of dispute settlement ranging from mediative forms to compulsory and more binding forms (such as in the WTO regime); and (iii) capacity building (and/or technical assistance) to deal with the limitation of the parties.[221]

The Chayeses submit that these three elements are part of a broader process of "jawboning" or "the effort to *persuade* the miscreant to change its way" or to induce compliance (what they call "*the uses of persuasion*"), and that these elements should be seen as management, rather than enforcement. This model would work because of the intertwining relationships states currently face, a reality that conflicts with the classic concept of sovereignty. Isolation by means of non-participation and the inability to benefit from the gains of participating in such a community (including different international regimes in different issue areas) would be the punishment for noncompliance.[222]

The Chayeses appear to endorse the idea that regimes change the payoff structure of countries when calculating on whether to comply or not to comply.[223] However, they see regimes playing a more active role than under the "institutionalist" perspective of regimes, in that regimes would play a role in "modifying preferences, generating new options, persuading parties to move toward increasing compliance with regime norms,

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[219] In relation to cooperative situations, the authors make explicit reference to Elinor Ostrom's study, *Governing the Commons*, a study on collective action (recall that a collective action problem is similar to a Prisoners' Dilemma situation, *see supra* note 144 and accompanying text). In Prisoners' Dilemma situations, transparency is one of the keys for cooperation (*see supra* note 87 and accompanying text). They also submit that under coordination problem, transparency is a transaction costs economizing tool (parties would behave coordinately anyway—the coordination equilibrium maximizes payoffs of all parties). CHAYES & CHAYES, *supra* note 26, at 22–23. **R**

[220] *Id.*

[221] *Id.* at 25.

[222] *Id.* at 27 ("sovereignty no longer consists in the freedom of states to act independently, in their perceived self-interest, but in membership in reasonably good standing in the regimes that make up the substance of international life").

[223] *Id.* at 7.

and guiding the evolution of the normative structure in direction of the overall objectives of the regime."[224]

(ii) WTO as a Managerial Regime.

Thus far, it is evident that the WTO regime adopts a great portion of the "managerial model," in that it incorporates all of its "jawboning" elements: transparency,[225] dispute settlement to deal with the problem of ambiguity (particularly with the institution of the Appellate Body—Article 3.2, DSU) and capacity building[226] (in the micro vision of the WTO DS, the establishment of the "reasonable period of time" serves to respect the "temporal dimension" of compliance[227]).

(iii) Limits of the Managerial Model for the WTO Regime.

Perhaps the main criticism of the managerial model is that has been depicted as an "alternative" to the coercive model of compliance.[228] Koh argues that the two models complement each

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[224] *Id.* at 229. *See generally* Koh, *Why Nations Obey*, *supra* note 12, at 2637–38.

[225] Many provisions under the WTO Agreements deal with the need to improve transparency of the trade practices of each WTO Member (for instance the *Understanding on the Interpretation of Article II:1(B) of the General Agreement on Tariffs and Trade 1994*), being the establishment of the Trade Policy Review Body (TPRB), under the Trade Policy Review Mechanism the most relevant one.

[226] WORLD TRADE ORGANIZATION, TRADING INTO THE FUTURE – INTRODUCTION TO THE WTO 55 (2d ed. 1998):

> [I]n its first two years, the WTO organized 203 technical cooperation activities, including seminars and workshops in various countries and courses in Geneva. Targeted are developing countries and countries in transition from former socialist or communist systems, with special emphasis on African countries. Seminars have also been organised in Asia, Latin America, the Caribbean, Middle East and Pacific.

[227] *See* Andrew W. Shoyer et al., Implementation and Enforcement of the WTO Agreements (on file with author).

[228] Koh makes the following additional criticisms of the managerial model: (i) the loss of reputation—Chayeses' reason for deterring states from noncompliance—will not occur unless the noncomplying party defies a mutually accepted interpretation of the norm; (ii) the Chayeses' process model "omits any detailed description of how the member states internalize the constraining norms" (consideration on the two-level game); and (iii) the Chayeses' approach overlooks the fairness and the legitimacy of the rules been enforced. Koh, *Why Nations Obey*, *supra* note 12, at 2639–41. *See, e.g.*, George W. Downs et al., *The Transformation Model of International Regime Design: Triumph of Hope or Experience?*, 38

other in allowing parties to bargain "in the shadow of the law"[229] (which is possible only because "the judge wields the power of ultimate sanction"). They also complement each other in allowing the complained Member to administer compliance in a "smoother" fashion. For instance, Article 22 of the DSU provides for a graduated proceeding seeking to pressure the defending Member to voluntarily comply with WTO rules. Such a graduated "jawboning" process disintegrates obligations in smaller pieces in order to make it more feasible for the defending Member to comply. The managerial model seems to provide means for making states to comply with their obligations in almost all situations (and this is consistent with Henkin's rule[230]). But it does not answer an extreme question: what should be done with states that "willfully disobey" obligations that are above the "acceptable level of compliance," in a level that could put cooperation under an international regime "at risk"?[231]

(a) The Acceptable Level of Compliance in the WTO Regime.

Although Henkin's admonition that the compliance puzzle should not be over-emphasized in the enforcement issue—since compliance rather than violation is the rule[232]—this paper shows

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COLUM. J. TRANSNAT'L L. 465 (2000) (summarizing the arguments for and against managerial regimes).

[229] As Shoyer put it, parties in a dispute bargain "in the shadow of the WTO," i.e., "each party to the dispute has an endowment, or bargaining chip, based on the outcome that the law will impose if no agreement is reached." Shoyer et al., *supra* note 227, at 5.

[230] *See supra* note 11 and accompanying text. **R**

[231] A caveat is mandatory: the idea of introducing this "worst-case scenario" query *does not* have the purpose of classifying specific cases eventually mentioned in this paper as cases where a "willful disobedience" of WTO rules occurred. Matters of intent sometimes lie in the eyes of the beholder and states presumably behave in good faith. Adding analysis of intent in the compliance puzzle may complicate the challenge of inducing enforcement even further. Such a query just serves to test the effectiveness of the managerial model under the WTO regime.

[232] This is also the rule in international trade issues: of the 304 complaints notified to the WTO as of December 23, 2003: (i) 42 have resulted in mutually agreed solutions; (ii) 24 were inactive or were settled based on withdrawal of a panel request or termination of a contested measure; (iii) 75 resulted in adopted panel or Appellate Body reports; and (iv) 25 were currently being reviewed in active panels. Only seven cases had reached the stage where it was necessary to determine a level of retaliation through arbitration pursuant to Article 22.6 of the DSU, and 4

that *enforcement* of DSB's recommendations is crucial in maintaining the effectiveness of the WTO regime. Indeed, history shows that WTO Members viewed compliance as a central issue under the WTO regime. They translated this concern into relevant provisions of the DSU (*e.g.*, Article 3.2 and Article 3.3), where they expressed that the DS is essential for the "effective functioning of the WTO" and for the "the maintenance of a proper balance between the rights and obligations of Members." These elements show that WTO Members have set the "acceptable level of compliance" with WTO rules at a very high level.

For instance, it is not yet clear whether or when the United States will comply with its obligations in the *U.S. – FSC* case, but the risks of a defection are already a serious concern for trade authorities on both sides of the Atlantic, especially given the potential to undermine the effectiveness of the WTO DS itself[233] (lest of defection becoming the controlling strategy). Thus, under the WTO regime, lack of compliance might collapse the system, as the concerns dominating the Uruguay Round clearly showed.

(b) Differences to the UN Regime.

Perhaps the main limitations of the managerial theory in relation to the use of sanctions stem from its focus on sanctions used under the United Nations regime. According to the Chayeses, the "voluntarism" of the UN collective action system (the UN has no "police force") turns the (economic, military, political) costs of sanctioning into an individual problem.[234] Provided there is a compelling reason to bring states to engage in the action (as happened with the U.S. in Korea, during the cold war period) or a broad consensus on the need to address the issue

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of theses cases consisted of twin cases. WTO, *Update of WTO Dispute Settlement Cases*, WT/DS/OV/18 (Dec. 23, 2003).

[233] For Pascal Lamy, the European Union trade commissioner, "[i]f the US and the EU, the two big elephants in the system, the two big pillars, don't comply, then the system has a problem." Edward Alden, *Lack of U.S. Compliance on rules "may hit WTO*," FIN. TIMES, Mar. 4, 2003, at 5. Lamy seems to have changed his perceptions on the compliance problem under the WTO system: on May 23, 2000, Lamy said that "[a]s long as you pay the penalties, you can go on as you are," Press and Communication Service Brussels, No. 3036, May 23, 2000, *quoted in* Mavroidis, *supra* note 10, at 808.

[234] CHAYES & CHAYES, *supra* note 26, at 52.

(Iraq, in 1991[235]), collective action will suffer the same problem that concerns collective action theorists (free-ride and/or lack of effectiveness especially when stronger countries do not engage in it). The same applies to operational issues, since UN collective action has been taken in an *ad hoc* fashion. Economic sanctions under the UN regime tend to be ineffective under such a regime[236] and may be an "one-way street"[237] that is effective only against weak countries.

(c) Insufficiency in Relation to the WTO Regime.

All of these elements seem to suggest that under the WTO regime, economic sanctions may be a proper way to deal with the enforcement of law.[238] First of all, unlike regimes dealing with health, environment, human rights or labor, the WTO regime is *the* regime where violations of rules may be "monetized" because of its issue-area. That is exactly the subject of the arbitration under Article 22.6 of the DSU. Secondly, the costs involved in a multilateral system of enforcement would be spread among the participants of the system, who are likely to participate considering the widespread sentiment in favor to strengthening the WTO DS. Those costs would be incurred in very few situations, because of the relatively low number of cases that so far have gone to the retaliation phase of the WTO DS proceeding (seven[239]) and the fact that the system proposed below would take place in a *minimalist* manner, i.e., in cases involving a weak complaining Member

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[235] The Chayeses mention the Korean and the Cuban cases (under the Organization of American states regime), but as they acknowledge, such cases should be seen under caveats, because, respectively, (i) support phased out as the time passed by (Korea); and (ii) important players did not explicitly approve those actions (Mexico and Brazil). *Id.* at 64–65.

[236] *See infra* note 240 and accompanying text. **R**

[237] CHAYES & CHAYES, *supra* note 26, at 67.

[238] The Chayeses submit that the coercive measures collectively taken under Chapter VII of the UN Charter are "not for law enforcement purposes but in the service of collective security." *Id.* But, maintaining world peace is what the UN Charter is all about. Bearing that in mind, this purpose was inserted in the UN Charter's Preamble and Chapter I.1. Actions directed at threatening and breaching the peace were outlawed under Chapter VII. By citing only the measures taken under Chapter VII, perhaps the Chayeses intended to make a clear distinction between security issues and non-security issues (regulatory treaties), a distinction that supports the general thesis of this paper.

[239] *See supra* note 232. **R**

against a strong complained one (so far, certainly *EC – Bananas –Ecuador (Article 22.6 – EC)* and perhaps *Canada – Aircraft* would be appropriate, as explained below). Thirdly, unlike the UN regime context, where economic sanctions seem to be ineffective in that they rarely induce changes in the behavior of the state,[240] in international trade, sanctions may impact constituencies that have the ability to influence the decision-making process of a Member. There is evidence suggesting that sanctions have been designed to "target" influential constituencies.[241]

(d) Merits of the Managerial Model for Institutions Dealing with Other Issues-Area – Soft and Hard Law.

Managerial regimes by themselves are very well designed for regimes dealing with issues such as the environment,[242] labor, and human rights. These issue-areas have common characteristics in that all involve "soft law."[243] In these regimes, the lack of coercive enforcement mechanisms ("hard law") permits the broadest gathering of participant states. As Alvarez puts it:

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[240] This is the Chayeses' conclusion in relation to the *Iraqi*, the *Former Yugoslavia*, and the *African* case (although in South Africa the effect of sanctions took 30 years to end apartheid). CHAYES & CHAYES, *supra* note 26, at 52, 58, 65.

[241] Agriculture is one of the products the EC included in the list of products to suffer retaliation as the result of the *U.S. – FSC* case (the other are textiles, machinery, footwear, paper and iron and steel products). *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Arbitration by the United States under Art 22.6 of the DSU and Article 4.11 of the SCM Agreement – Decision of the* Arbitrator, WT/DS108/ARB, *adopted* Aug. 30, 2002 [hereinafter *U.S. – FSC*]. *See* Tobias Buck, *EU Closer To Imposing Trade Sanction On U.S.*, FIN. TIMES, Apr. 24, 2003, at 6. The setting of intellectual property as the target in the *EC – Bananas – Ecuador (Article 22.6 – EC)* case seems to support this assertion too. The EC carefully chose the list of products to be subject to retaliation in case the U.S. did not lift the steel safeguards until December 10, 2003. *See* Council Regulation 1031/2002, 2002 O.J. (L 157) 8.

[242] *See* Robin R. Churchill & Geir Ulfstein, *Autonomous Institutional Arrangements in Multilateral Environmental Agreements: A Little-Noticed Phenomenon in International Law*, 94 AM. J. INT'L L. 623 (2000) (evaluating the roles institutional arrangements, such as conferences and meetings of parties—COP, MOP—through multilateral environmental agreements (MEAs) play in managing environmental regimes).

[243] Some scholars define that the "hardness" or the "softness" of international law commitments lies not only on the existence of binding legal commitments, but on three elements, namely: "legal obligation," "precision of commitments" and "delegation to third-party institutions." Kenneth W. Abbott & Robert O. Keohane, *The Concept of Legalization*, 54 INT'L ORG. 401 (2000).

[I]t is argued that establishing a low threshold of commitment entices states to join, permits the diffusion of information, and begins the collective deliberation that will lead to a deepening of the regime since what is important is to "engage states" such that they are encouraged to create a domestic bureaucracy capable of seeing the treaty regime as part of its core mission. At the same time reporting and other interstate compliance tools (short of binding dispute settlement) facilitate the gradual solidification of treaty norms, while helping to establish the operation of supportive "epistemic communities" both in and outside the treaty regime. Legally binding commitments, such as obligations to report, are combined with 'soft' or vague commitments (particularly at the outset) to reduce the price of admission. Consensus decision making within the COPs also serves to lessen predictable objections concerning national sovereignty and widens the sense of commitment.[244]

The GATT regime itself began as a "soft law" regime in order to attract a largest possible number of participants.[245] It began without a dispute settlement system but later developed some procedures to solve disputes (or, to resolve ambiguity).[246] During

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[244] JOSE E. ALVAREZ, INTERNATIONAL ORGANIZATIONS AND TREATY MAKERS (forthcoming) (excerpt on file with author) [hereinafter ALVAREZ, INTERNATIONAL ORGANIZATIONS].

[245] "Equally important, the United States made disproportionate tariff concessions during the GATT's early stages to induce multilateral tariff reductions and incorporate more states with the GATT." Charles Lipson, *The Transformation of Trade: the Sources and Effects of Regime Change*, *in* INTERNATIONAL REGIMES 233, 235 (Stephen D. Krasner ed. 1983).

[246] Churchill & Ulfstein draw a comparison between MEAs and the original design of the GATT, precisely depicting the metamorphosis above mentioned:

> The first of these [traditional International Governmental Organizations-IGOs] treaty arrangements, chronologically speaking, is the General Agreement on Tariffs and Trade (GATT). Between its adoption in 1947 and the birth of the World Trade Organization in 1994, the GATT displayed many of the organizational features of the MEAS considered above. Above all, it was not a formal intergovernmental institution. Instead, periodic meetings of the parties were held under Article XXV and were serviced by a permanent secretariat and supported by various subsidiary bodies. The meetings of the parties developed the normative content of the Agreement, and through the subsidiary bodies exercised a supervisory role over its implementation and observance by the parties. In general, decision making was by consensus.

Churchill & Ulfstein, *supra* note 242, at 656. *See also* ALVAREZ, INTERNATIONAL ORGANIZATIONS, *supra* note 244:

the 1960s, GATT dispute settlement practically came to a halt due to the need to accommodate the establishment of the EC. During and after the 1970s, "[t]he WTO became a dynamic "managerial regime" capable of incremental expansion of subject matter even while it deepened its commitment to "hard law" backed by (relatively) "hard enforcement."[247]

The managerial regime remains insufficient to deal with the needs of the WTO Members. In addition to the reasons above explained, a coercive model is also necessary because there are more incentives to cheat in the WTO regime (cooperation situation) than in other issue areas, which generally involve coordination situations.[248] Furthermore, enforcement under the WTO DS should not be lax today because there is a critical mass of participant Members encompassing, with the accession of China and Russia, all of the major players in international trade.

III. Analysis of Propositions

There have been few proposals for the development of a multilateral system of enforcement. Some proposals have been made in a theoretical context and other proposals have been made under the framework of the Doha Development Round negotiations. These proposals will be examined below. Propositions that deal with the improvement of BEMs (such as

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Modern treaty regimes that have established distinct patterns for using newly created institutional mechanisms for on-going assessment, interpretation or supervision are prevalent with respect to human rights, arms control, and especially the environment. It is important to remember, however, that even older entities, such as the pre-WTO GATT, were 'managerial' regimes in the sense described here.

[247] Jose E. Alvarez, *The WTO as Linkage Machine*, 96 AM. J. INT'L L. 146, 147 (2002). This shift from a "soft law" to a "hard law" regime supports the previous analysis on the occurrence of a change *within* the WTO regime as reflected in the WTO Agreements. *See supra* Section II.C.2.(vi).

[248] Abbott & Snidal precisely captured the complementary of managerial and coercive models of compliance, and their usefulness according to the issue-area involved: "[a]n overly sharp distinction between managerial and enforcement functions is misleading. For many significant day-to-day activities—especially ones involving coordination—incentives to defect are relatively small compared with the benefits of cooperation; here, the managerial approach is sufficient. In other cases, some enforcement may be necessary, at least potentially." Abbott & Snidal, *supra* note 118, at 26,

mandatory retroactive compensation,[249] linking the level of countermeasures to the benefit rather than the damage,[250] mandatory negotiations seeking market access in disputes involving developed and developing countries,[251] punitive damages,[252] pecuniary compensations (fines) and reparation (including past damages)[253]) will not be analyzed because they are out of the scope of this paper.

A. Multilateral Enforcement Mechanisms (MEMS)

In a study focusing on the role of multilateral trade institutions in relation to trade negotiation and enforcement of trade rules (considering both the monitoring and sanctioning functions of a multilateral institution), Giovanni Maggi supported multilateral enforcement mechanisms (MEMS). Interestingly, Maggi qualified his support by saying that the application of MEMS (with third-party sanctions) should be "minimal" (in the sense of being precise) and should only be used in cases where bilateral sanctions alone cannot deter defections, which is more likely to happen when there is imbalance of power between parties to a dispute.

To reach these conclusions, Maggi's study approached the issue from a multilateral Prisoners' Dilemma framework of three-countries. In Maggi's model, each country has two partners (three countries in the game) and is a net importer from the partner at its right and a net exporter to the partner at its left. "At the Nash equilibrium, each country selects the same tariffs. . . on imports coming respectively from the left and the right partner. The tariff imposed on the right partner is higher. . ., as a higher volume of imports gives the government a higher incentive to tax them." As he puts it, all countries would be better off under global free trade than at the Nash equilibrium (where countries select equal tariffs for imports and exports).[254] In addition, the

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[249] Pauwelyn, *supra* note 9, at 345–46; Mavroidis, *supra* note 10, at 807.

[250] Mavroidis, *supra* note 10, at 806—07.

[251] *Id.* at 811 (citing a proposition of Jagdish Bhagwati).

[252] *Id.* at 812–13.

[253] *Id.*

[254] Maggi, *supra* note 88, at 195. *See generally* Kyle Bagwell & Robert W. Staiger, Reciprocity, Non-discrimination and Preferential Agreements in the Multilateral

model shows the occurrence of *bilateral imbalances of power* stemming from the different levels of imports and exports maintained with each country's partners, which leads to different losses (or gains) if trade wars take place. Thus, the author defines the stronger country as the one that loses less "(or gains) if the two countries move from free trade to the static Nash tariffs." To sum up: the net importer is more powerful than the net exporter.[255]

In an iterated Prisoners' Dilemma game, Maggi examined the effectiveness of two types of enforcement mechanisms: one of a bilateral nature (BEM)[256]and another of a multilateral nature (MEM).[257]

Maggi then demonstrated that in a multilateral system a stronger country is likely to defect against both other players because it will suffer retaliation from both sides anyway. Thus, in the presence of bilateral imbalances of power, a multilateral system of enforcement is a better instrument in sustaining a higher symmetric equilibrium payoff. This is because a multilateral system doubles the loss stemming from defection (although simultaneously doubling the gains from defection as well—the *two sides of the coin*), making it possible for a weaker player to punish defections from a stronger partner and thus enhancing cooperation. Thus, in a multilateral system, it is the stronger player who makes the larger concession, while under a bilateral enforcement system it is the weaker partner who does so. Finally, absent imbalances of power, "bilateral and multilateral enforcement are equally efficient."[258]

Although favoring the adoption of MEMS, Maggi does not propose the total elimination of BEMS. Instead, Maggi suggests that the two mechanisms should be coupled and applied jointly. Thus, a defecting player would face three constraints in case of

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Trading System 19 (on file with author): "whether or not political-economy effects are present, the Nash equilibrium is inefficient, and the inefficiency always takes the form of a trade volume that is too low."

[255] Maggi explains that "in this setting, each country is more powerful than its right partner, and weaker than its left partner." Maggi, *supra* note 88, at 195.

[256] Obviously, this is the system currently in place under the WTO DSU.

[257] Under MEMS, "any defection leads to a permanent Nash reversion in both bilateral relationships which the defector is involved in". Maggi, *supra* note 88, at 197.

[258] *Id.* at 198–99.

defection: two BEMs (seeking to deter defection against the player imposing the BEM) and one MEM (aiming to deter defection simultaneously against both players).[259] BEMs would always be applied fully (in terms of duration) and maximally (in terms of severity). The level of the MEMs, on the other hand, would vary. Maintaining flexibility of third-party sanctions reduces the incentives for the defecting party to defect simultaneously against the other two players (the *two sides of the coin*).[260] On the other hand, raising BEMs up to a level beyond the indifference curve of the defecting player is inefficient in terms of compliance because, beyond the indifference curve, the decision to defect controls, regardless of how high the level of the BEMs is set.[261] Therefore, the addition of a MEM can shift the indifference curve of the defecting player, in terms of losses incurred with the other trading partner(s). The idea is that MEMs should be applied up to the point where the defecting player begins to make larger concessions than the other players (minimal level). MEMs should also be applied at a minimal level because third-country governments incur higher political costs than the injured country in imposing third-party sanctions.[262] Thus, the introduction of MEMs seems to create less trade diversion than the current imposition of MEMs alone. As the number of participants in the game increases, the severity of the MEMs each participant in the system impose against the defecting player will decrease. Thus, the already *minimal* costs of imposing MEMs are likely to diminish significantly in the WTO context, given that it has 146 Members.

Furthermore, in providing weak countries (today the majority of the WTO Members) with effective means to retaliate against stronger countries, the introduction of MEMs would further strengthen the idea of multilateralism under the WTO domain. The introduction of MEMs also helps to diminish the incentives of creating Hartinian-like "conflicting power centres," which only favor stronger countries. By spreading the costs of sanctions, the

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[259] *Id.* at 202.

[260] The lowering in the incentives to defect simultaneously against both players seems to stem from the "relative" uncertainty in the payoff structure, in that the level of retaliation is certain in relation to the BEM (full and maximal) but not in relation to the MEM.

[261] *Id.* at 202.

[262] *Id.* at 203.

MEMs help address the problem of free-riders in collective action problems, where actors generally lack the incentives to bear the costs of sanctioning.

Maggi suggests that MEMs should not be used when there is no imbalance of powers between the parties to a dispute. There, parties will have sufficient leverage to retaliate effectively. Although the *DISC* case took almost five years to be assessed by a GATT panel and more than eight years of negotiations on whether and how the U.S. would comply with GATT panel's findings, the U.S. ultimately complied with the findings, having replaced the DISC legislation with the now challenged FSC/ETI one. In the *U.S. – FSC* case, the Arbitrators under Article 22.6 of the DSU considered the level of suspension of concessions and obligations that the EC proposed to be "appropriate." The Arbitrators expressly excluded the possibility of imposing *punitive* measures.[263] The Arbitrators did not consider it necessary to lower or to raise the level of countermeasures, probably because the players involved in the dispute were the two strongest Members of the WTO regime and also the amount approved for retaliation (US$4.043 billion) was already significant.

The outcome was different in *Canada – Aircraft*. The Arbitrators did not invoke the fact that Brazil was a developing country (this argument was not put forward in the case), but granted an increase of twenty percent on the level of the countermeasures. Most interestingly, the Arbitrator rejected the claim to evaluate the appropriateness of the countermeasures in relation to the volume of trade existing between Brazil and Canada and also dismissed the concern that applying "disproportionate" retaliation in such a context could jeopardize the relationship between those countries. At the end, the twenty percent mark-up illustrates the Arbitrator's concern in assuring compliance.

This discussion raises new questions: how does one calculate the imbalance of powers? Should it be calculated in an absolute or in a relative manner? In the *EC – Bananas – Ecuador (Article 22.6 – EC)* dispute, there is no doubt that Ecuador was a weaker player compared to the EC. There is no doubt that the U.S.. and

[263] *U.S. – FSC*, *supra* note 242, ¶ 5.62.

the EC are on an equal footing. But what about Brazil and Canada? Canada is a developed country and one of the seven richest countries in the world. But Brazil is one of the leading developing countries and the fifteenth largest economy in the world. The trade exchange between those two countries is not negligible (US$927 million a year[264]). This is an issue that warrants further study.

B. Proposals in the WTO Working Group on Dispute Settlement - The Mexican Proposal: "Negotiable Rights" of Retaliation

Pauwelyn submits that a collective action approach in favor of a prevailing developing country could already be taken under Article 21.7 ("the DSB shall consider what further action it might take which would be *appropriate* to the circumstances").[265] As explained above, the term "appropriate" does not necessarily means "equivalent" or "limiting" and encompasses both a quantitative and a qualitative dimension, being the objective of the latter to induce compliance. Therefore, there would be room to apply creative measures such as MEMs in cases involving developing countries.[266]

However, the taking of such revolutionary action without the explicit agreement of all WTO Members in a legislative capacity would serve to undermine the support that WTO Members provide for the system. The term "appropriate" under Article 21.7 is a standard rather than a rule,[267] revealing the inability of the WTO Members to agree on the subject. Even if the issue is referred to the WTO DS, it should be noted that the WTO adjudicating bodies cannot add to or diminish the rights and obligations

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[264] *Canada – Aircraft*, *supra* note 191, ¶ 3.42.

[265] Pauwelyn, *supra* note 9, at 345 n.59.

[266] *See supra* note 257 and accompanying text.

[267] Pauwelyn, *supra* note 9, at 345 n.59. Rules are "clear, self-executing, fully specified in advance and not in need of interpretation or construction." Joel P. Trachtman, *The Domain of WTO Dispute Resolution*, 40 HARV. INT'L L.J. 333, 337 (1999). A standard is "a law that is, in relative terms, farther toward the other end of the spectrum. It establishes general guidance to both the person governed and the person charged with applying the law but does not, in advance, specify in detail the conduct required or proscribed." *Id.* at 350–51. "[T]he distinction relates to how much work remains to be done to determine the applicability of the norm to a particular circumstance." *Id.* at 351.

provided in the covered agreements (Article 3.2, DSU). In this sense, the use of a standard ("appropriate") to authorize a collective action could increase the legitimacy-democracy deficit of the institution, since "the public choice costs of specification of rules are increasingly countervailed by the costs in terms of legitimacy of decision pursuant to a standard by a dispute resolution tribunal."[268] That being said, it is important to verify to what extent the WTO Members are considering to implement such a system in a legislative capacity.

The WTO Members are currently re-negotiating the provisions of the DSU. More than fifty proposals have been presented so far. They focus on institutional (such as the move towards a system of a permanent panelists[269]), procedural (the "sequencing" issue involving under Articles 21.5 and 22.6,[270] enhancing transparency, allowing *amicus curiae* submissions, introducing remand authority for the Appellate Body,[271] improving the compliance panel mechanism and the reasonable period of time for a Member concerned to comply with a DSB recommendation,[272] litigation costs,[273] among many others) and substantive issues (*e.g.*, the need to enhance compensation as an alternative to retaliation[274]). On September 9 and 10, 2002, the LDC Group Proposal

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[268] *Id.* at 376.

[269] *Contribution of the European Communities and its Member States to the Improvement of the WTO Dispute Settlement Understanding*, TN/DS/W/1, at 2–3 (Mar. 13, 2002) [hereinafter EC Proposal].

[270] *Id.* at 4–5. *See also* Proposal by Ecuador, *Negotiations on Improvements and Clarifications of the Dispute Settlement Understanding*, TN/DS/W/26, at 3–4 (Nov. 26, 2002).

[271] EC Proposal, *supra* note 269, at 4–8. *See also* Permanent Mission of the United States, Communication, TN/DS/W/13 (Aug. 22, 2002).

[272] Submission by Canada, Colombia, Costa Rica, Ecuador, Japan, Korea, New Zealand, Norway, Peru, Switzerland and Venezuela for Examination and Further Consideration by the General Council, *Proposal To Amend Certain Provisions Of The Understanding On Rules And Procedures Governing The Settlement Of Disputes (DSU) Pursuant To Article X Of The Marrakesh Agreement Establishing The World Trade Organization*, WT/GC/W/410, at 2–3 (Sept. 29, 2000).

[273] Indian Proposal, *supra* note 2, at 2.

[274] EC Proposal, *supra* note 269, at 5–6. *See also* Permanent Mission of Ecuador, Communication, *Contribution of Ecuador to the Improvement of the Dispute Settlement Understanding of the WTO*, TN/DS/W/9, at 3–5 (July 8, 2002).

and the Indian Proposal suggested that the WTO DS should incorporate a system of "collective retaliation."[275] One month later, Mexico presented a concrete proposition along the same lines.

1. The Proposition.

Mexico put forward a proposal under which a Member having the right to retaliate against another Member would be able to sell its "rights" of retaliation to other WTO Members.[276] This proposal seems to be consistent with the proposals discussed before, although it does not yield the same efficacity of the MEMS, which allow the sharing of the costs of sanctioning throughout the participants of the system. Nevertheless, it could be a first step towards a multilateral system of enforcement.

This idea is not completely new in the international area. The parties to the *Kyoto Protocol to the United Nations Framework Convention on Climate Change* ("*Kyoto Protocol*") have agreed, individually or jointly, to reduce global emissions of carbon dioxide and other greenhouse gases to agreed percentages

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[275] *See supra* note 2 and accompanying text. **R**

[276] Permanent Mission of Mexico, Communication, TN/DS/W/23 (Nov. 4, 2002):

> The suspension of concessions phase poses a practical problem for the Member seeking to apply such suspension. That Member may not be able to find a trade sector or agreement in respect of which the suspension of concessions would bring about compliance without affecting its own interests.(footnote omitted). There may be other Members, however, with the capacity to effectively suspend concessions to the infringing Member.
> Members should be allowed to "negotiate" the right to suspend concessions or other obligations towards another Member. In other words, if the infringing Member has not negotiated acceptable compensation, the complainant may agree with a third Member the transfer of the right to suspend concessions in exchange for a negotiated benefit (i.e., 'A' may agree with 'B' the transfer of the right to suspend concessions or obligations to 'C' in exchange of a mutually agreed benefit, which may even take the form of cash).
> 'Negotiable rights' are an economic concept, and should be tradeable. Furthermore, many domestic legislations, in recognition of the need to provide effective remedies for complaining parties, allow them to "negotiate" their rights with third parties. In Mexico's opinion, this concept might help address the specific problem facing Members that are unable to suspend concessions effectively.

See also Permanent Mission of Mexico, Communication, TN/DS/W/40 (Jan. 27, 2003) [hereinafter Mexican Proposal II], which complements the previous communication, presenting drafts for provisions incorporating these propositions in the DSU.

over the next years. Under Article 6 of the *Kyoto Protocol*, parties may engage in the exchange of "emission reduction units" by means of the transfer, sale or acquisition of such units (or "emissions trading," according to the terms of Article 17 of the *Kyoto Protocol*). Theoretically, emissions trading enables the parties to the *Kyoto Protocol* to jointly administer the global level of emissions, permitting parties that are not able to comply with their obligations to acquire further "rights to pollute." Thus, the agreed global level of emissions may remain stabilized. Although different in scope, the *Kyoto Protocol*'s emission trading mechanism may indicate the willingness of the international community to adopt creative forms of dealing with collective action problems, such as those addressed under the protocol, and those presented by the problem of enforcing WTO rules.[277]

2. Problems and Suggestions.

Countries not involved in a dispute may lack the incentives to acquire "rights of retaliation" because they would be easy targets of stronger countries in eventual retaliations (even if disguised ones). One may say that the existence of these incentives would depend on the bargain offered by the country originally holding the "rights" (the "Holder") to a potential buyer (the "Knight"). The Holder could offer the Knight privileged market access for a product, service or sector. For instance, if the DSB authorized the Holder to retaliate against the Defector up to the level of US$50 million in the sectors of goods and services, the Holder would be able to sell "rights" to the Knight (and/or others) up to that amount.

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[277] Another indication of such a willingness refers to a statement the EC made during the proceedings of the *U.S. – FSC* case, which were reflected in the Arbitrators' decision, as follows:

> [W]e take note, on this point, of the statement by the European Communities: '. . .it may well be that the European Communities would be happy to share the task of applying countermeasures against the United States with another member and voluntarily agree to remove some of its countermeasures so as to provide more scope for another WTO Member to be authorized to do the same. This will be another fact that future arbitrators could take into consideration.'

EC response to question 42 from the Arbitrator, ¶ 116, *in U.S. – FSC*, *supra* note 241, ¶ 6.29.

This framework gives rise to several problems: (i) lack of laundering effect; (ii) any negotiations would only encompass the qualitative dimension of the countermeasures (the sectors), since the quantitative dimension (the amount of the authorized retaliation) cannot be the subject of negotiations; (iii) the Knight would be able to apply retaliation against the Defector, but the trading of the "rights" would lead to preferential treatment for the Knight but to the detriment of the other WTO Members.

Perhaps these issues could be addressed by involving the DSB in the process.[278] After the Holder and the Knight have approved the terms of their transaction, they would request the DSB to take note of the transfer and, if the Knight chooses to apply a cross-retaliation, the Holder and the Knight would request authorization from the DSB, which would verify whether the already existing "practicability or effectiveness" test was met.[279] The DSB's participation would confer a laundering effect on the Knight's retaliation and the possibility of cross-retaliation would help to minimize effectiveness problems in Knight's retaliation.

The application of privileged treatment to the Knight would generate an incentive for a larger number of Knights to be interested in the "rights." Depending on the factual situation of the case, the attractiveness of the Holder's market, the willingness of a Knight to use the "rights" against the Defector and even the sense of solidarity in solving a collective action problem[280], the offer of "rights" may actually create a market for "rights." (*see*

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[278] The same suggestion holds for operational purposes of implementing the Sanction Pills.

[279] The Mexico Proposal suggests that the parties ask the DSB to authorize such a transfer:

> 7 bis. The right to suspend concessions or other obligations may be transferred to one or more Member(s). In that case, the Member(s) transferring the right to suspend concessions or other obligations and the Member(s) acquiring such right shall jointly request the DSB that it authorize the latter to suspend concessions or other obligations. In that case, the DSB shall grant each acquiring Member authorization to suspend concessions or other obligations within 30 days of such request, unless the DSB decides by consensus to reject the request. In no case shall the transfer(s) exceed the level of suspension authorized by the DSB.

Mexican Proposal II, *supra* note 276, at 6.

[280] The *African* cases are a remarkable example of such sense in the international arena. *See supra* note 240 and accompanying text. **R**

Section B.3 below). The larger the number of Knights, the lower the sanctions costs would be, turning retaliation more effective.

Finally, one problem that illustrates the insufficiency of this proposal compared to the MEMs, is that if the level of retaliation authorized to Holder is too low (BEM), the Knight's retaliation would not be effective, because it would not be able to change the indifference curve of the Defector, even if cross-retaliation is authorized.

3. Auctioning "Rights of Retaliation."

Bagwell, Mavroidis & Staiger examined a system of auction of "rights of retaliation" inspired by the Mexican Proposal.[281] They showed that interesting results may arise if the Defector participates in the auctions for "rights of retaliation" since it will prefer that "no country win to the possibility that a foreign country [Knight] wins, since retaliation is avoided only in the former cases." They further clarify that "Home [Defector] should not be permitted to bid to retire the right of retaliation against it unless the political costs of retaliation against Home. . . and/or the size of the retaliation. . . are sufficiently large." Finally, they suggest that the Defector's participation in the auction will depend on the purpose that auctions (or countermeasures) "are expected to serve in the WTO-retaliation setting."

That said, it appears that a Defector should not be allowed to participate in auctions of rights of retaliation. That would amount to allowing the Defector to make an "efficient breach" of its obligations or, in other words, to pay the price of non-compliance. This would not be consistent with the idea that WTO Members are interested in compliance itself (*in natura*).

IV. CONCLUSION

The propositions presented in this paper may be seen as merely theoretical. However, as Pauwelyn put it: "one of the objectives of legal research is to prepare the ground for

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[281] Kyle Bagwell et al., *The Case for Auctioning Countermeasures in the WTO*, *at* http://www.ssc.wisc.edu/~rstaiger/auctionation032903.pdf.

change."[282] In the international trade terrain, one of the objectives of legal research is to also prepare the ground for future negotiations. The propositions now presented and analyzed may serve WTO Members—especially developing countries and the LDC Group—in making their way in enforcing WTO adjudicating bodies' decisions. This is crucial for the maintenance and development of the WTO regime.[283]

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[282] Pauwelyn, *supra* note 9, at 347. This and Mavroidis, *supra* note 10, at 811, were the first works calling for studies on the implementation of a multilateral/collective action system of enforcement in the WTO regime.

[283] Rather than merely theoretical, there are signs from scholarship and from WTO adjudicating bodies' decisions indicating a certain acceptance of the idea of implementing a more multilateral/collective action system of enforcement. For instance, the Arbitrators in the *U.S. – FSC* case expressly recognized the *erga omnes* nature of the obligation of a WTO Member in relation to the WTO rules. *See U.S. – FSC*, *supra* note 241, ¶ 6.10.