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Legal Issues in Relation to Financial Compensation under the Cotton Initiative

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This Negotiating Policy Brief has been prepared to assist African countries with respect to the Cotton Initiative in the WTO. It was drafted, under the supervision of Dominique Njinkeu by Ms Nicola Loffler, and has benefited from useful insights from several ILEAP advisors. Comments can be sent to the ILEAP Secretariat (dominique.njinkeu@ileap-jeicp.org)

CONTENTS:	Page
1. Introduction	3
a. Issues	3
2. Cause of Action	3
a. Reduction commitments under the AoA	4
i. Domestic Support	4
1. Reclassification	5
2. Potential Law Reform	6
3. Breach of Object and Purpose	6
ii. Export Subsidies	7
iii. Conclusion re breach of reduction commitments	8
b. Breach of general principle of free trade	8
3. Causation and the quantification of damages	9
a. Causal link between subsidies and injury	9
i. Causes of depression of world prices	10
ii. Earnings forgone / amount of prejudice	10
b. Direct / indirect prejudice	11
c. Level of nullification or impairment	12
d. Retroactive compensation	12
4. Remedies	13
a. Political History	13
i. Arguments for monetary compensation	15
ii. Arguments against monetary compensation	16
iii. Other frameworks for monetary compensation	17
b. Legal Analysis	17
i. Dispute Settlement Understanding	18
ii. Case Law	18
1. Inducing compliance: past v future injury	19
2. Inducing compliance: influence on interpretation	19
iii. Special and Differential treatment	21
iv. Object and Purpose of Treaty	23
v. Relevance of Customary International Law	23
c. Potential Law Reform	24
5. Conclusion	26
BIBLIOGRAPHY	27

1. Introduction:

This paper will analyze the legitimacy of the claim for financial compensation in relation to cotton subsidies,¹ as requested under the Sectoral Initiative in Favour of Cotton brought by Benin, Burkina Faso, Chad and Mali in the 5th Ministerial WTO Conference in Cancun.

These requests were formulated in a Draft Decision submitted to the WTO by Benin, on 22 August 2003.² The draft decision proposed the establishment of a “transitional financial compensation mechanism in favour of the cotton-exporting LDCs” for a period of three years.³ The proposed compensation would be equivalent to the amount of the loss in export revenue suffered by the LDCs affected by these subsidies.

a. Issues:

In establishing a claim for compensation for the damages caused by cotton subsidies, the claimant countries would have to establish three main legal points:

1. a cause of action, such as a breach of an obligation under an international trade agreement,
2. a causal link between the subsidies and the injury, in order to demonstrate a reasonable quantification of damages equivalent to the injury, and
3. the legitimacy of the remedy of monetary compensation for this breach.

It seems that the first question, regarding a cause of action, is a relatively simple question. This involves analysis of the obligations under the Agreement on Agriculture (AoA), and a factual comparison with the current performance in order to establish a breach. The second question requires complex legal and economic analysis, and will be central to any legal or political challenge of cotton subsidies.

The third question is certainly the most controversial. The claimant countries would have to establish that this remedy is available under either the Dispute Settlement Understanding or under customary international law. The issue of monetary compensation was initially raised in the 1960s, and has been deliberated by scholars and trade negotiators for decades, without a legal or political conclusion.

This paper will briefly address the first and second questions and flag the main issues arising in these areas. However the focus of this paper will be on the third question – that is, the legitimacy of the remedy of monetary compensation. The paper will provide a brief historical survey of the issue, as well analysis from both a legal and political perspective.

2. Cause of Action

Under the Cotton Initiative, the West and Central African countries request the complete elimination of domestic support and cotton export subsidies over three years.⁴ This claim has an extremely strong moral and political basis, as explained in the documents presented to the WTO.⁵

¹ including domestic support measures and subsidies granted to the production and export of cotton

² *Draft Decision concerning specific measures in favour of cotton with a view to poverty alleviation*, Communication from Benin, Burkina Faso, Chad and Mali, WT/GC/W/511

³ Para 2.1 of the Draft Decision

⁴ Para 1 of the Draft Decision

⁵ TN/AG/GEN/4, TN/AG/GEN/6, WT/MIN(03)/W/2

Despite this, the claim goes far beyond the current commitments under the AoA. As explored below, the commitments made under the AoA are extremely specific. Certain forms of subsidies have been completely exempted from reduction commitments. In addition, even those that are ‘illegal’ under the AoA, limited reduction commitments have been set, generally around 20%, rather than the 100% reduction (in the form of a 33% reduction per year) requested under the Cotton Initiative.⁶

a. Reduction Commitments under the AoA:

The reduction commitments in relation to agricultural subsidies (including cotton), as agreed to by the international community, are found in the Agreement on Agriculture (AoA).⁷ Under the AoA, there are potentially two different breaches occurring in relation to the subsidizing of Cotton production in Western countries (especially the United States). Firstly, the provisions of Domestic Support contained in Articles 6 & 7, and secondly the provisions on Export Subsidies contained in Article 8 & 9.

i. Domestic Support:

In relation to domestic support measures, the AoA divides subsidies into three categories: green, blue and amber box subsidies.⁸ Green box subsidies are permitted as long as they “meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects on production”. Similarly, blue box subsidies are permitted, and reduction commitments do not apply, whereas Amber box subsidies are subject to reduction commitments. Amber box subsidies are those that influence production, or have a trade-distorting effect.

The Agreement establishes a ceiling on the total domestic support (calculated as the Aggregate Measurement of Support or AMS) that governments may provide to domestic producers, and requires that the AMS should be reduced by agreed percentages. As explained below, this is a horizontal rather than vertical method of calculating subsidy commitments. In general (for non-developing countries) the commitment is a 20% reduction over the 5 year implementation period.

Economic analysis has shown that the US has fulfilled this commitment of a 20% reduction in AMS, despite the fact that the total amount of subsidies has actually increased. The US has achieved this under the 1996 US Farm Bill, which has the effect of ‘reclassifying’ a massive amount of subsidies from the amber to the green category, with frequent recourse to the *de minimis* clause.⁹ The *de minimis* clause permits the exclusion of an amount of support from the calculation of the AMS where the support does not exceed 5 per cent of the country’s total agricultural production.¹⁰ This clause, in effect, gives the US a \$10 billion margin of maneuver.¹¹ Goreux points out that without recourse to this clause, US subsidies would in fact have exceeded the agreed limit, as the amount of amber subsidies would have been raised by 44% in 1999 and 2000.¹²

⁶ Para 1 of the Draft Decision

⁷ NOTE: the initial draft suggested that the Agreement on Subsidies and Countervailing Measures (SCM Agreement) may also be applicable, however these only apply to industrial products.

⁸ The different elements of these subsidies are defined in Annex 2 of the AoA. Green box subsidies are those that “have no, or at most minimal, trade-distorting effects or effects on production... [and] do not have the effect of providing price support to producers” (Annex 2:1). Blue box subsidies are “direct payments under production limiting programmes” with specific requirements (Annex 2:5). Amber box subsidies are those that are considered trade distorting.

⁹ Goreux, Louis, *Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa*, June 2003, p. 33

¹⁰ Agreement on Agriculture, Article 4(a)(ii)

¹¹ Goreux, p. 21

¹² Goreux, p. 17

There still remains a possibility that the most recent US subsidy system, as introduced under the 2002 Farm Bill, may actually result in a breach of the AMS commitments. There are a variety of new payments which are likely to fall within the ‘amber’ category, despite US assertions that they are still ‘green box’ payments.

The most glaring examples of subsidies that have been wrongly categorized are those of direct payments, minimum price payments, and anti-cyclical measures. The Oxfam report notes that direct payments that were once ‘de-coupled’ under the old Farm Bill, have effectively been ‘re-coupled’ under the 2002 Farm Bill.¹³ Under this Bill, payments are linked to the production during the reference period of 1998-2001, rather than the 1986-88 period, as in the previous Bill. Oxfam highlights that “this seemingly technical change” has the result of raising entitlements to subsidies and, has in effect, “‘re-coupled’ subsidies to production”.¹⁴ As a result, such payments should no longer fall within the ‘green box’ category. In addition, Goreux notes that the Bill introduces anti-cyclical measures such as “the emergency payments that had been given to cotton ... growers following the 1997/98 price decline”.¹⁵ These payments are linked to the market price of cotton, and Goreux highlights that these “seem to fall into the amber category”.¹⁶

A detailed analysis may not be possible at the present, however, as the details of US subsidies are only reported to the WTO after a lag period of around two to three years.¹⁷ In addition, these are issues that are being considered by the WTO Panel established at the requested of Brazil, in relation to US Cotton Subsidies, as discussed below. A claim for such a specific breach of the AoA would be the most preferable legal option, however other options may still be possible as explored below.

1. Reclassification:

As examined above, the US has used a technique of ‘reclassifying’ subsidies from the amber to the green category, in order to avoid breaching the terms of the AoA. Goreux stresses the reality that the “limit will be observed in its wording, but not in its spirit”.¹⁸ In fact, in terms of total subsidies, the US has actually increased the level from \$857 million (in 1996/7) to \$3.705 billion (in 2001/02), with the effect of producer prices in the US being 91 percent higher than world prices.¹⁹ So although the US has met its 20% commitment to reduction of AMS, it has actually increased the level of subsidies by over 300% within the cotton sector over the past five years.

Although this massive increase in ‘total subsidies’ is a good moral and political basis for complaint, there is still no solid legal ground for challenging such an increase. This ‘reclassification’ seems to be a technique of avoidance and evasion similar to that commonly used in relation to domestic taxation legislation. In the domestic context, governments typically respond to this type of evasion by reforming the legislation to ‘close the loophole’, or by smart prosecution techniques. This paper will now discuss these two options in the current context.

¹³ Oxfam Briefing Paper, *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*, 2002, at http://www.oxfam.org/eng/pdfs/pp020925_cotton.pdf, p. 15

¹⁴ Oxfam, p. 15

¹⁵ Baffes, John, “Cotton: Market Setting, Policies, Issues and Facts”, *World Bank Paper*, January 2004, p. ix

¹⁶ Goreux, Louis, *Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa*, June 2003, p. 17

¹⁷ Goreux, p. 16, citing Babcock, “US Farm Policy and the WTO: How Do They Match Up?” Working Paper 02-WP294, p. 11 and Graph p. 12, Iowa State University, February 2002

¹⁸ Goreux, Louis, *Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa*, June 2003, p. 16

¹⁹ Baffes, John, “Cotton and Developing Countries: A Case Study in Policy Incoherence”, *World Bank Trade Note*, September 10, 2003, p. 2

2. Potential Law Reform:

The solution of law reform is obviously much simpler at the domestic level than it is at the international level. The claimant countries could propose reforms of the AoA to close this ‘loophole’ in a variety of ways. This could involve better defining the categories of classification, or by altering the classification system itself.

In relation to the definition of categories, this is an issue that has been previously raised by the claimant countries. As a part of their proposal to the WTO, they have called for a “strict and mandatory definition of the various subsidy boxes”.²⁰ However the problem seems to be deeper than this, and may require a more radical solution. It seems that two of the key problems are the method of AMS calculation, as well as the *de minimis* clause. As noted in the WTO Negotiations on Agriculture ‘overview’ document, various proposals are on the table in this regard.²¹

From the perspective of the claimants, there is a major problem with the fact that the calculation of the AMS is not product specific.²² It seems that a vertical approach (one product at a time), rather than the current horizontal approach (non-product specific, as under the AMS) would be much more beneficial for the claimant countries.²³ Without a vertical approach, they may not be able to benefit from any reduction in subsidy levels as cotton is their only interest. The second problem is the negative consequences of the *de minimis* clause. Goreux points out that without recourse to this clause, US subsidies would in fact have exceeded the agreed limit.²⁴ As noted in the ‘overview’ document, one possibility is for the reduction of the value in the *de minimis* clause with a view to its elimination.²⁵ For the reasons explored above, such a proposal should be supported by the claimant countries.

Although this paper will not go into the detail of potential reforms, these are certainly areas of reform that have the potential to significantly benefit the claimant countries. It is not clear, however, whether such proposals would have much political support. In fact the ‘loopholes’ probably exist because of the political necessity of governments being able to have flexibility in the way they implement their reduction commitments across various industries. However these potential reforms are certainly areas which should be further researched. It must also be remembered that pursuing legal reform would have the additional benefit of having a more broad impact on subsidy reduction in general (beyond the cotton industry) and for this reason would be preferable to pursuing a specific action in relation to cotton.

3. Breach of object and purpose:

Working under the current wording of the agreement, it still may be possible to succeed in coming up with a valid legal argument that a breach has in fact occurred. It may be possible to argue that

²⁰ *Poverty Reduction: Sectoral Initiative in favour of Cotton*, Joint Proposal by Benin, Burkina Faso, Chad and Mali (TN/AG/GEN/4), para 30

²¹ Negotiations on Agriculture – Overview (TN/AG/6) 18 December 2002, para 45

²² See Goreux, Louis, *Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa*, June 2003, p. 15

²³ Goreux, p. 21

²⁴ Goreux, p. 17

²⁵ Negotiations on Agriculture – Overview (TN/AG/6) 18 December 2002, para 45

the ‘objects and purposes’ of this agreement was to reduce the overall level of subsidies which have the effect of distorting trading patterns. In line with Article 31(1) of the Vienna Convention of the Law of Treaties, this ‘object and purpose’ must be taken into account in the interpretation of the meaning of these specific articles.²⁶

The problem with this legal argument is that during the negotiations of the AoA, it is clear that the strategy selected by the international community of reducing subsidies was based on the calculation of the AMS, rather than using a product specific calculation scheme. Although in hindsight we can see that this method of calculation does not seem to produce the desired effect of subsidy reduction, especially from the perspective of the claimant countries, this still does not seem to provide a legal foundation for a breach of the Agreement (despite this establishing a good political basis for calling for reform of this section). In addition, the counter-argument for the allegation of such a breach is that it was the object and purpose of these articles to allow governments flexibility in the way they implement their reduction commitments across various industries, as discussed above.

ii. Export Subsidies:

In relation to the Export Subsidies, article 9 of the AoA requires countries to undertake commitments to reduce their use. Countries are permitted to use the six categories of subsidies listed in article 9.1, provided they agree to undertake commitments to reduce both the amounts of subsidies (expressed in terms of budgetary outlays) and the quantities of subsidized exports. Under article 10, these countries are under an obligation not to exceed the commitment levels shown in their schedules in respect of both budgetary outlays and volumes. They are also under an obligation not to extend the coverage of products for which subsidies can be granted beyond that specified in the schedule.

There seems to be a possible breach in relation to the ‘Step 2’ subsidies introduced by the US under the 2002 Farm Bill. As examined in the Oxfam report, the total export subsidization under this heading was around \$197m in 2001.²⁷ In contrast, however, “the US scheduled no export subsidies for cotton in the list of subsidies”, as required under the AoA. As the Oxfam report highlights, the AoA “does not permit a WTO member ... to provide any export subsidies beyond the quantity and values listed in its export-subsidy schedule”.²⁸

The US government counters this claim on the basis that “Step 2 payments are not export subsidies, in the WTO’s definition, since any user of American cotton can claim them”.²⁹ Yet it is unlikely that this argument will stand up to legal scrutiny. Even if this legislation is not discriminatory on the face of it, there are clearly discriminatory effects due to the \$197 million given to traders in 2001 explicitly to export cotton.³⁰ This could possibly amount to *de-facto* discrimination – “a concept well-developed in GATT/WTO law”.³¹

²⁶ Article 31(1) of the Vienna Convention on the Law of Treaties states that a "treaty shall be interpreted in good faith in accordance with the ordinary meaning given to the terms of the treaty in the context and in light of its object and purpose"

²⁷ Figures from the International Cotton Advisory Committee, as quoted in Oxfam Briefing Paper, *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*, 2002, http://www.oxfam.org/eng/pdfs/pp020925_cotton.pdf p. 15

²⁸ Oxfam Briefing Paper, *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*, 2002, at http://www.oxfam.org/eng/pdfs/pp020925_cotton.pdf p. 26

²⁹ Oxfam, p. 26

³⁰ Oxfam, p. 26

³¹ WorldTradeLaw.net, “Dispute Settlement Commentary (DSC): Panel Report, *Japan - Measures Affecting Consumer Photographic Film and Paper (WT/DS44/R)*”, available by subscription only, at <http://www.worldtradelaw.net/dsc/Search/SearchDSC.htm>, p. 9

In brief, the provisions relating to export subsidies may be another area being breached by industrialized countries, however further research is required before examining the details of such breaches, and assessing the validity of these claims.

iii. Conclusion re breach of reduction commitments:

These reduction commitments are technical and complex, and must be analyzed in much greater detail before one could draw conclusions in relation to specific breaches. As noted above, the legality of US cotton subsidies is currently being challenged at the WTO by Brazil.³² A panel was established following Brazil's request in February 2003, however the panel has yet to hand down a decision. This decision will help to clarify whether the US subsidies are in fact in breach of the reduction commitments under the AoA, and as such it would be prudent for the claimant countries to wait until these issues have been determined, before embarking on a separate legal challenge.

b. Breach of general principle of free trade:

It has been suggested that although many of the subsidies are technically 'permissible' under the AoA, they are contrary to the general principle of free trade. This argument is problematic from both a legal and political perspective.

Although the global trading system is fundamentally concerned with the issue of 'free trade', it is clear that this is not always the over-riding principle. Determining the legality of a trade restriction will almost inevitably involve the balancing of trade and non-trade concerns (such as environmental standards, labor standards, development concerns etc.) The claimant countries would have to be careful with the precedent that an argument based on an overriding principle of 'free trade' would set. In many instances, it seems that developing country interests are not in fact fully in line with an *a priori* assumption that freedom of trade is to be the prevailing principle in international trade law. There are many examples of developing countries seeking the promotion of the status of non-trade considerations above that of freedom of trade, as voiced by *fair trade* activists, such as the importance of food security and linkage between commodity prices and poverty reduction.

Similarly, if we look at the history of the international political system, it is clear that the over-riding principle is in fact that of sovereignty, and the right of nation-states to pursue policies which protect the interests of their citizens. Sovereign states have the right to pursue their national interests as long as they do not breach international law in this pursuit. This sovereign right has without doubt been the over-riding principle guiding international law over the past century.

Developments in international law have generally been made with the consent of nation-states, such as under an agreement or treaty. The only way the provisions of a treaty can be altered or contested under international law, is by the application of customary international law and the principle of *jus cogens*. The term *jus cogens* encompasses the fundamental norms of international law that are binding on all states and cannot be overridden by specific treaty commitments, such as prohibitions on aggression, slavery and genocide.³³ It is clear, however, that the principle of 'free trade' has not

³² United States – Subsidies on Upland Cotton: Request for the Establishment of a Panel by Brazil (WT/DS267/7) 7 February 2003

³³ Definition of *jus cogens*: "peremptory principles of international law that cannot be overridden by specific treaties between countries; that is: norms that admit of no derogation; they are binding on all states at all times (e.g.,

attained the status of *jus cogens* in international law, and for good reason (such as the balancing of norms that is attempted under the WTO system.)

For these reasons, there seems to be no solid legal foundation for an argument that cotton subsidies are illegal on the basis of a breach of the principle of free trade. Rather a legal case will have to be made in relation to the specific reduction commitments determined by each international agreement, as examined above.

3. Causation and the quantification of damages:

In addition to proving a breach of an AoA reduction commitment, the claimant countries would have to prove that this breach caused “nullification and impairment” to their cotton industries, and would have to request a reasonable quantification of damages equivalent to this level of nullification or impairment.

In the Draft Decision, it was proposed that compensation would be “equivalent to the amount of the loss in export revenue suffered by the LDCs affected by these subsidies”.³⁴

The main problem with this claim is that it seems to be based on **all** cotton subsidies provided by industrialized countries, rather than just the subsidies that are in breach of reduction commitments under the WTO agreements. Although this would be reasonable in a situation where commitments have been made for the “complete elimination” of subsidies as envisaged by the Draft Decision, as explained above this is clearly not a reflection of the commitments currently made by the international community under the WTO Agreements. As a result, the legal limit for compensation must relate only to the subsidies in breach of reduction commitments.

An additional problem is that the quantification of damages is in reality an extremely difficult issue, and involves analysis of questions relating to the causes of the depression of world cotton prices, as well as the potential for the claimant countries to benefit should the subsidies be lifted, as discussed below.

a. Causal link between subsidies and injury

The issue of causation would be crucial in both the negotiation process for monetary compensation, as well as during any legal challenge of cotton subsidies. In the legal arena, pursuant to A3.8 of the DSU, there would be a presumption that a “breach of the rules has an adverse impact” on the claimant countries, and it is “up to the Member against whom the complaint has been brought to rebut the charge”. However it is likely that this presumption would be challenged by the defendant in such a case, and would be a crucial element of such a legal challenge.

The issue of causation has been addressed in various manners under the WTO. The causation standard used by the Panel in the *Japan – Photographic Film and Paper* case, to determine whether nullification or impairment had occurred, was whether the measures made “more than a *de minimis* contribution to nullification or impairment”.³⁵ As noted in legal commentary, “this standard appears

prohibitions on aggression, slavery, and genocide)”, from *Beck's Law Dictionary: A Compendium of International Law Terms and Phrases*, available at <http://www.people.virginia.edu/~rjb3v/latin.html>

³⁴ *Draft Decision concerning specific measures in favour of cotton with a view to poverty alleviation*, Communication from Benin, Burkina Faso, Chad and Mali (WT/GC/W/511)

³⁵ WorldTradeLaw.net, “Dispute Settlement Commentary (DSC): Panel Report, *Japan - Measures Affecting Consumer Photographic Film and Paper* (WT/DS44/R)”, available by subscription only, at <http://www.worldtradelaw.net/dsc/Search/SearchDSC.htm>, p. 17

to be quite low, compared with other causation standards applied under the WTO Agreement”.³⁶ For instance, in the *U.S. - Wheat Gluten Safeguards* case, the Appellate Body ruled that the standard of causation to be applied by WTO Member governments in safeguard investigations is whether there is a “genuine and substantial relationship of cause and effect between increased imports and injury”.³⁷

In contrast, Hudec suggests that the causation requirement under the DSU is restricted to the notion of ‘equivalence’. He suggests that A22.4 of the DSU, which determines that the retaliation “shall be equivalent to the level of nullification of impairment”, establishes a legal concept of ‘balance’ between the amount of retaliation and the size of the loss from the offending measure that is not tied to any particular theory about how to measure and compare harms.³⁸ He notes that it has been GATT practice to avoid elaborate calculations in relation to trade data and statistics, and argues that GATT panels have in the past “rendered an almost perfunctory decision that explains none of its underlying calculations in detail”.³⁹

Although the legal questions remain somewhat unclear, it seems that in relation to the present case, the issue of causation would require the careful examination of two different issues. First, analysis would have to demonstrate the extent to which the depression of world cotton prices is attributable to the subsidies concerned. Secondly, one would have to assess the earnings forgone by the claimant countries as a result of this depression of prices.

i. Causes of depression of world prices

The depression of world cotton prices is attributable not only to the subsidies provided by industrialized countries, but also to a variety of other factors. As Goreux notes, other factors include (1) market competition from synthetic fibers, (2) the recent economic slow-down (including the Asian Financial Crisis), and (3) the fluctuations in exchange rates.⁴⁰ It is also clear that cotton is not a unique case. The real price of most commodities has been declining over the past 20 years. This general trend can also be attributable to reductions in the cost of production due to technological improvements and inelastic demand growth. It is clear that these issues are extremely complex, and would be very difficult to quantify.

ii. Earnings forgone / amount of prejudice

The second issue relates to the amount of earnings forgone by the claimant countries as a result of the subsidies. In this regard, it is necessary to analyze the level of benefit that the claimant countries would theoretically achieve as a result of a removal of the subsidies, and the associated re-inflation of prices. This is another complex question, which has been analyzed by various scholars, as summarized below.

According to a World Bank paper, the removal of US subsidies would produce a fall in US production that would lead to an increase in the price of cotton by as much as 12 cents per pound.⁴¹

³⁶ *ibid.*

³⁷ *ibid.*

³⁸ Hudec, Robert, “Broadening the Scope of Remedies in WTO Dispute Settlement”, in Weiss & Weirs (eds.), *Improving WTO Dispute Settlement Procedures*, Cameron May Publishers, 2000, www.worldtradelaw.net/articles/hudecremedies.pdf, p. 23

³⁹ Hudec, p. 24

⁴⁰ Goreux, Louis, *Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa*, June 2003, p. 11

⁴¹ Badiane, Ghura, Goreux and Masson, “Cotton Sector Strategies in West and Central Africa”, *World Bank Policy Research Working Paper 2867*, July 2002, p. 13

Figures put out by the ICAC support this finding, and predict a similar increase of 11 cents per pound.⁴² The World Bank paper concludes that such an increase in price “would increase revenues from cotton by about \$250 million in WCA countries”.⁴³ Similarly, an Oxfam report concludes that in 2001, Sub-Saharan Africa lost \$302 million as a result of US subsidies.⁴⁴

Goreux, one of the co-authors of the World Bank paper, provides more detailed analysis specific to the claimant countries in his June 2003 paper. In this paper, he uses complex economic models to “simulate the prices that would have prevailed in the last five years if subsidies had been eliminated in [the US, China, Greece and Spain]”.⁴⁵ His analysis concludes that the total “net earnings foregone by cotton sectors” in the claimant countries is approximately \$80 million per year.⁴⁶ For Mali, this figure averaged \$29.1 million per year over the past five years. For Benin, the figure was \$21.9 million, for Burkina Faso, \$18.9 million, and for Chad, \$10.9 million.⁴⁷ His paper also provides figures for the “net export earnings forgone” by these countries, which are around 40% higher than the “net earnings foregone by cotton sectors”.⁴⁸

The Oxfam paper has made similar calculations based on the ICAC predicted price increase of 11 cents per pound. Their findings for “foreign exchange losses as a result of US cotton subsidies” in 2001/02 are slightly higher than the World Bank estimates of “net export earnings forgone”, with the following figures: Mali \$43 million, Benin \$33 million, Burkina Faso \$28 million, and Chad \$16 million.⁴⁹

The commentators generally agree that Western and Central African (WCA) countries are among the world’s lowest cost producers of cotton, and would thus be in a position to benefit from the removal of cotton subsidies.⁵⁰ For example, data from the Food and Agricultural Policy Research Institute (FAPRI) suggests that the removal of distortions would benefit Africa more than twice the amount it would benefit Uzbekistan, and more than four times that of Australia.⁵¹

b. Direct / indirect prejudice

In addition, there is debate over whether compensation should include an amount in relation to indirect, as well as direct prejudice. It is suggested that if export earnings were to increase in these countries, there would be a further increase in GDP as a result of the associated increase in spending of the cotton growers. As Goreux points out, the calculation of indirect prejudice is unreliable, as a

⁴² ICAC figures, as quoted in Oxfam Briefing Paper, *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*, 2002, at http://www.oxfam.org/eng/pdfs/pp020925_cotton.pdf, p. 13

⁴³ Badiane, Ghura, Goreux and Masson, p. 13

⁴⁴ Oxfam Briefing Paper, *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*, 2002, at http://www.oxfam.org/eng/pdfs/pp020925_cotton.pdf, p. 17 and Annex 5

⁴⁵ Goreux, Louis, *Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa*, June 2003, p. 22

⁴⁶ See Goreux, p. 29, Table 5.

⁴⁷ See Goreux, p. 29, Table 5.

⁴⁸ Compare Tables 5 and 6, Goreux, p. 29

⁴⁹ Oxfam, p. 18

⁵⁰ Badiane, Ghura, Goreux and Masson, “Cotton Sector Strategies in West and Central Africa”, *World Bank Policy Research Working Paper 2867*, July 2002, p. 12

⁵¹ FAPRI data shows that on average, Africa’s cotton exports would increase by 12.6%, Australia by 2.7%, Uzbekistan by 6% and the US cotton exports would decline by 3.5% per year over the next 10 years if the distortions were removed. FAPRI (2002), *The Doha Round of the World Trade Organization: Liberalization of Agricultural Markets and its Impact on Developing Economies*, paper presented at the IATRC Winter Meetings

result of the potential for double-counting.⁵² Most importantly, Goreux points out that “a legal case to the WTO has to be presented on the basis of direct prejudice” only.⁵³

c. Level of nullification or impairment

As expressed in article 22.4 of the DSU, the amount “authorized by the DSB shall be equivalent to the level of the nullification or impairment”.⁵⁴ The ‘level of nullification or impairment’ is a relatively ambiguous phrase, and has been the subject of extensive legal commentary.⁵⁵ In relation to the present situation, the phrase seems to refer to the loss of potential exports. In order to determine this amount, one would have to take into account the causal link, as discussed above, as well as the reduction commitments. This paper will not attempt to make such calculations, however as noted above, a potential WTO DSB would be faced with the task of “listen[ing] to all of the related information and to all the various theories of measurement”, in order to make such a decision.⁵⁶

d. Retroactive compensation

It is clear from legal commentary that although the term ‘compensation’ is used in the DSU, this does not have the same meaning as in the domestic context. In the domestic context, compensation relates to damages for economic harms done by past legal violations. In contrast, ‘compensation’ at the WTO is entirely forward-looking. Commentators highlight that there is no remedy for past wrongs, and “no compensation for the economic harms done by legal violations”.⁵⁷ Hudec points out that the only exception to this rule is in relation to anti-dumping and countervailing duties cases (AD/CDV).⁵⁸ Hudec notes that between 1985 and 1995, there were a series of AD/CDV cases in which panels ordered refunds of duties imposed in violation of GATT rules.⁵⁹ Hudec questions why the AD/CDV’s have been singled out for the more demanding remedies, and concludes that this may be related to the fact that these are specific obligations in relation to specific firms.⁶⁰ It seems that the specificity of the AD/CDV claims is in stark contrast to the general and complex nature of the current claim, and thus there would be no legal basis for arguing for retroactive compensation under WTO rules.

Therefore if the case was to be argued before the WTO, the causation analysis in relation to the link between the subsidies and injury would have to focus on the future – that is, the 2002 Farm Bill, and the way this will affect the claimant countries’ industries in the future. The history of past subsidies under the previous Farm Bill will be relevant in proving the breach of reduction

⁵² Goreux, Louis, *Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa*, June 2003, p. 27

⁵³ Goreux, p. 27

⁵⁴ Although this provision relates to “the level of the suspension of concessions or other obligations authorized by the DSB” rather than the level of compensation to be granted, this notion would be applicable by way of analogy.

⁵⁵ See eg. Frieder Roessler, “The Concept of Nullification and Impairment in the Legal System of the World Trade Organization,” in Ernst-Ulrich Petersmann, ed, *International Trade Law and the GATT/WTO Dispute Settlement System*, 1997, p. 125

⁵⁶ Hudec, Robert, “Broadening the Scope of Remedies in WTO Dispute Settlement”, in Weiss & Weirs (eds.), *Improving WTO Dispute Settlement Procedures*, Cameron May Publishers, 2000, www.worldtradelaw.net/articles/hudecremedies.pdf, p. 24

⁵⁷ Hudec, Robert, “Broadening the Scope of Remedies in WTO Dispute Settlement”, in Weiss & Weirs (eds.), *Improving WTO Dispute Settlement Procedures*, Cameron May Publishers, 2000, www.worldtradelaw.net/articles/hudecremedies.pdf, p. 34

⁵⁸ Hudec, p. 15

⁵⁹ Hudec, p. 17

⁶⁰ Ibid.

commitments and the causation link, however it is the current Farm Bill that would be used to measure the compensation to be awarded. However this does not preclude the claimants from requesting compensation for past harm during negotiations, but it is clear that such a claim would have a political rather than legal foundation.

4. Remedies

As mentioned in the introduction, the question of the availability of financial compensation as a potential remedy is extremely controversial. In general, academic commentators agree that there is a possible legal foundation for a claim, however the details of such potential have not been fully explored.

At a World Bank conference, financial compensation was described as being “a legally thinkable remedy”, although it was dismissed on the basis that it was “unlikely to be [politically] feasible”.⁶¹ Academic commentary has similarly noted that “in principle, there is nothing to prevent countries from seeking compensation - the fact that complainants do not customarily request compensation is rooted in the history of the GATT”.⁶²

This paper will first analyze the political history of the issue of monetary compensation before turning to the legal elements of the argument.

a. Political Analysis

Monetary compensation has almost never been employed under either the GATT⁶³ or WTO (except under the TRIPS agreement),⁶⁴ although the idea has been debated since as early as the early 1960s, in respect of the GATT.⁶⁵ Even under the GATT, where the international trading system had no ultimate enforcement mechanism, monetary compensation was an issue already being debated. In 1965 Brazil and Uruguay proposed that panels be given authority to propose an “indemnity of a financial character” in complaints by developing countries against developed countries.⁶⁶ Many objections were raised in relation to this proposal, including that “it was inconceivable that national legislatures would be willing to vote budgetary provisions for this purpose.”⁶⁷

The establishment of the Dispute Settlement Body under the WTO dramatically altered the potential for remedies in the international trading system. Under the DSU, trade-related mechanisms such as sanctions and the suspension of concessions became an available form of remedy. This paper will

⁶¹ The WTO/World Bank Conference on Developing Countries' in a Millennium Round WTO Secretariat, Centre William Rappard, Geneva, 20-21 September 1999

⁶² Hoekman & Mavroidis, “WTO Dispute Settlement, Transparency and Surveillance”, http://www1.worldbank.org/wbi/trade/papers_2000/dispute_settlement.pdf

⁶³ Reimbursement of duties paid —i.e., a limited form of financial compensation—has however been recommended in a few antidumping related cases under the GATT. See Palmetter, David and Petros C. Mavroidis. 1999. *Dispute Settlement in the World Trade Organization: Practice and Procedure*. The Hague: Kluwer Law International

⁶⁴ Article 45 of the TRIPS agreement provides for damages adequate to compensate for the injury. There has been a recent agreement in relation to the US: Copyright Act Case (WT/DS160), and this was the first time that an arrangement has involved the payment of monetary compensation in the WTO dispute settlement system. See WT/DS160/23 and http://www.dfat.gov.au/trade/negotiations/disputes/bulletin/wto_disputes-bulletin-jan2002.html

⁶⁵ Charnovitz, “Rethinking WTO Trade Sanctions” *American Journal of International Law*, Vol 95, No. 4, October 2001, pp. 792-833, Footnote 330

⁶⁶ Charnovitz, FN 330, as above, quoting “Report of the Ad Hoc Group on Legal Amendments to the General Agreement, *reprinted in* GATT, Expansion of Trade of the Developing Countries 112, 119 (Dec. 1966)

⁶⁷ Charnovitz, FN 330, as above

closely analyze the implications of the DSU provisions in a later section, however at this stage it is important to note that the remedies recognized as being available under the DSU all have the characteristic of being self-enforcing – that is, there is no need for a body to implement the decisions of the Panel or Appellate Body, as the parties are simply permitted to ‘settle the score’ in the form of trade sanctions between themselves.

Since the establishment of the WTO DSU, the issue of ‘monetary compensation’ has once again been raised both by member states and by academics. In 1999, Pakistan raised the issue to the General Council, suggesting that it “would be useful to clarify that the term “compensation” used in Article 22 includes grant of financial compensation ...”⁶⁸ The importance of the issue has also been stressed by many academics, including Bhagwati,⁶⁹ Pauwelyn,⁷⁰ and Horlick.⁷¹

The issue was further raised at Doha. As part of the Doha Ministerial Declaration, the international community agreed to negotiate on improvements and clarifications of the Dispute Settlement Understanding by May 2003.⁷² As a part of this process, proposals were raised by various member states. The LDC Group (TN/DS/W/17), the African Group (TN/DS/W/15) and Kenya (TN/DS/W/42) proposed introducing the notion of monetary compensation in the event that an offending measure is left in place against a developing or least-developed country.⁷³ These proposals will be further discussed in the section 4(c) on law reform.

The issue of ‘monetary compensation’ was one of many proposals debated under the Special Session of the DSB, in accordance with the Doha work programme. The Chairman of the Special Session of the DSB, Ambassador Péter Balás, put forward a ‘Chairman’s Text’ in May 2003,⁷⁴ containing proposals for reform on a significant number of issues, including “the enhancement of compensation as a temporary remedy for breach of WTO law ... and ... the strengthening of special and differential treatment for developing country Members”. It is interesting to note, however, that the proposals specifically addressing the issue of ‘monetary compensation’ were not included in the Chairman’s text, due to “the absence of a sufficiently high level of support” according to commentators.⁷⁵

In addition to these political moves by various developing countries, the US has, itself, also drafted proposals in relation to monetary compensation under the WTO. In 2000, the Meltzer Commission⁷⁶ proposed that “instead of retaliation, countries guilty of illegal trade practices should pay an annual fine equal to the value of the damages assessed by the panel or provide equivalent

⁶⁸ WT/GC/W/162

⁶⁹ Bhagwati, Jagdish, “Trade: the Unwinnable War”; *Financial Times*, 29 January 2002, p. 17

⁷⁰ Joost Pauwelyn, *Enforcement and Countermeasures in the WTO: Rules Are Rules---Toward a More Collective Approach*, 94 AJIL 335, 339 (2000)

⁷¹ Horlick, Problems with the Compliance Structure of the WTO Dispute Resolution Process, Paper Prepared for Conference at the University of Minnesota Law School (Sept. 15--16, 2000).

⁷² Paragraph 30, Doha Ministerial Declaration

⁷³ ICTSD, “Review of the DSU”, *Doha Round Briefing Series*, Vol 2, No 8 of 13, August 2003, http://www.iisd.org/pdf/2003/wto_doha_review_dispute_2.pdf

⁷⁴ Job(03)/91.

⁷⁵ Working paper No 47 - November 2003, The Doha Development Round Negotiations on the Dispute Settlement Understanding, Peter Van den Bossche, <http://www.law.kuleuven.ac.be/iir/eng/wp/WP47e.pdf>

⁷⁶ The Meltzer Commission, (officially known as the International Financial Advisory Commission (IFIAC)), was established by Congress in November 1998, with a mandate to study the role and effectiveness of 7 international institutions (the International Monetary Fund, the World Bank Group, the Inter-American Development Bank, the African Development Bank, the Bank for International Settlements, and the World Trade Organization) and recommend future U.S. policy towards them.

trade liberalization”.⁷⁷ Although there has been implementation of many of the recommendations made by the Meltzer Commission in relation to the various international banks, it seems that the recommendations on the WTO have been largely ignored.⁷⁸

i. Arguments for monetary compensation

The basis for the claim of monetary compensation, according to the ICTSD⁷⁹, is that “the current - and very rare - practice of voluntarily granting compensation through deepened market access is not working for poor countries - often because they do not have the supply-side capacity to use access to export markets outside their traditional ones; or because their competitive edge might have been seriously hurt by the condemned action in the market of destination”.⁸⁰

Essentially it is argued that trade sanctions are simply not effective for developing countries, as sanctions favor larger economies over smaller ones. Charnovitz affirms this claim, explaining that the effectiveness of sanctions depends on “the size of an economy” as well as “the import dependency of the sender and the export dependency of the target”.⁸¹ Commentators have widely endorsed the payment of a monetary fine to the injured state as a beneficial option for developing countries. Economists like monetary fines because unlike retaliation it does not impose any costs on the injured states and it could be used directly to compensate export interest groups harmed by trade inconsistent measures.⁸² In addition, it has been suggested that monetary damages may induce compliance more effectively than trade retaliation because governments would have to pay the costs, rather than shift them.⁸³

For the claimant countries in particular, trade sanctions or the suspension of concessions would be both ineffective and undesirable. As expressed in their claim to the WTO, the suspension of concessions for other products would not be effective for the cotton-producing LDCs because they only have a few other export products and, in most cases, these already receive preferential access.⁸⁴ Similarly, they are not in a position to increase customs tariffs on imports, as the “majority of their imports are essential for development and poverty reduction”.⁸⁵ In addition, even if this was a desirable option, it would not be an effective incentive for the US or EU to comply with the WTO Agreements, as the market share held by these LDCs is so low as to be meaningless. These two trade-related remedies are therefore counterproductive for cotton-producing LDCs.

⁷⁷ Meltzer, Allan H. 2000. *Report of International Financial Institution Advisory Commission*, <http://www.house.gov/jec/imf/meltzer.htm>

⁷⁸ In fact the WTO recommendations were not even mentioned in the *Report on Implementation of Recommendations Made by the International Financial Institutions Advisory Commission*, October 2001, see <http://www.treas.gov/press/releases/reports/meltzer.pdf>

⁷⁹ International Center for Trade and Sustainable Development

⁸⁰ ICTSD, “Review of the DSU”, *Doha Round Briefing Series*, Vol 2, No 8 of 13, August 2003, http://www.iisd.org/pdf/2003/wto_doha_review_dispute_2.pdf

⁸¹ Charnovitz, “Rethinking WTO Trade Sanctions”, *American Journal of International Law*, Vol 95, No. 4, October 2001, p. 794

⁸² Jide Nzelibe, *The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization's Dispute Resolution Mechanism*, p. 10

<http://www.law.upenn.edu/ile/ILE%20Cegla%20Papers/Nzelibe,%20Credibility%20Imperative.pdf>

⁸³ Nzelibe

⁸⁴ TN/AG/GEN/4, para 37

⁸⁵ TN/AG/GEN/4, para 37

ii. Arguments against monetary compensation

Although there are many strong arguments for the use of monetary compensation, commentators also highlight the counter-arguments; namely, legal uncertainties and the problem of enforcement. It has been argued that “Many WTO members, including developing countries, have been unwilling to go down this track, perhaps in part due to uncertainty regarding possible repercussions (e.g., regarding potential liability). Some countries have also argued that their legal systems prohibit compensation^{86, 87}”.

Another problem with using monetary compensation is that it is not a self-enforcing remedy. Commentators have highlighted that “unlike retaliation, the successful imposition of monetary fines depends on some affirmative act by the scofflaw state”.⁸⁸ An enforcement problem may arise as a state may simply refuse to pay. Although some commentators have argued that it is because of these difficulties, that there are very few examples of international agreements that incorporate monetary fines as a remedy,⁸⁹ this does not seem to be the case.

In contrast, research has shown that considerable experience exists with a monetary payment or financial compensation being awarded by an arbitral tribunal as well as treaties with reparations agreements. The use of monetary fines under the European Court of Justice and the North American Agreement on Environmental Cooperation provide possible frameworks for such a development.⁹⁰ Commentators have pointed out, however, that “fines may work in the case of the European Community because of the huge transfers that take place between Brussels and the member states and the numerous other ‘confederal’ linkages. Such transfers between the WTO and its members, however, are not common”.⁹¹

Further, monetary damages are not completely foreign to the WTO system itself. In fact Article 45 of the TRIPS Agreement provides for compensatory damages, and this provision has formed the basis of a recent monetary agreement in relation to the *US: Copyright Act Case* (WT/DS160).⁹²

⁸⁶ Although it can be pointed out that a basic principle of public international law holds that domestic law cannot be invoked to deviate from an international obligation (Art. 26 Vienna Convention on the Law of Treaties)

⁸⁷ Hoekman & Mavroidis, op cit.

⁸⁸ Jide Nzelibe, *The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization's Dispute Resolution Mechanism*, <http://www.law.upenn.edu/ile/ILE%20Cegla%20Papers/Nzelibe,%20Credibility%20Imperative.pdf>

⁸⁹ Jide Nzelibe, *The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization's Dispute Resolution Mechanism*, <http://www.law.upenn.edu/ile/ILE%20Cegla%20Papers/Nzelibe,%20Credibility%20Imperative.pdf>

⁹⁰ *The most prominent use of fines is found in the Treaty Establishing the European Community, where a penalty payment can be imposed against a member state that fails to comply with a judgment of the European Court of Justice. This step was taken for the first time in July 2000, when the Court agreed to a penalty of 20,000 euros per day against Greece. ...*

In 1993 the NAAEC provided the possibility of a "monetary enforcement assessment" as a remedy in dispute settlement. The NAAEC offers dispute settlement on whether a government is effectively enforcing its domestic law. It is neither a fine nor a damages judgment because the money is paid to the commission to be used to enhance environmental law enforcement in the country paying the assessment. This pecuniary provision has seen no use since the NAAEC went into force in 1994. The NAAEC also contains remedies aimed at collecting the monetary assessment. Canada agreed to a provision for a court order that it pay an assessment. Mexico and the United States did not agree to such direct enforcement. Yet they did agree that the complaining party's government could suspend trade benefits if the losing party did not pay an assessment.

⁹¹ Asim Imdad Ali, LL.M., *Non-Compliance and Ultimate Remedies Under the WTO Dispute Settlement System*, <http://www.princeton.edu/~jpia/pdf2003/Ch%201%20WTO-Ali-JPIA%202003.pdf>

⁹² See WT/DS160/23 and http://www.dfat.gov.au/trade/negotiations/disputes/bulletin/wto_disputes-bulletin-jan2002.html

iii. Other frameworks for monetary compensation:

Monetary compensation is a widely recognized remedy in trade disputes on a regional and bilateral level. Interestingly, the United States itself has supported a proposal from Chile to introduce a remedy of monetary fines in bilateral trade agreements with Chile and Singapore.⁹³ The proposal purportedly suggested that “money be placed in an escrow account, which could be automatically released upon a legal judgment”.⁹⁴ As noted on the Office of the United States Trade Representative (USTR) website, the FTA with Chile includes “An innovative enforcement mechanism includes monetary penalties to enforce commercial, labor, and environmental obligations of the trade agreement”.⁹⁵

In addition, various mechanisms exist at the multilateral level. For example, NAFTA contains provisions that allow the award of monetary damages, both in its controversial Chapter 11 on Investment,⁹⁶ and the North American Agreement on Environmental Cooperation (NAAEC), which is a parallel agreement to NAFTA.

It is clear that proposals for monetary compensation are not new. It is certainly possible that the current political environment, involving the review of the DSU within the broader Doha ‘development’ agenda, will provide a new opportunity for implementing monetary compensation schemes. It remains unclear, however, whether monetary compensation will be a politically feasible solution to the potential trade dispute in relation to the Cotton Initiative.

b. Legal Analysis

This remaining section of the paper will analyze the legal issues arising in relation to the potential for monetary compensation as a remedy in a trade dispute.

The claimant countries would have to establish that monetary compensation is available under either the Dispute Settlement Understanding or under customary international law. This paper will first look at article 22 of the DSU, and assess the current and potential interpretations of this provision. This assessment will involve a focus on case law, the object and purpose of the provisions, and the potential wider interpretation based on the special and differential treatment as mandated in A21. The paper will also touch on the issue of quantification of damages, by assessing

⁹³Shaffer notes that at FN 127, pg 67 of his article, citing the following: *U.S. Looks to Fines, Sanctions Mix for Chile, Singapore Talks*, INSIDE U.S. TRADE 8 (Oct. 25, 2002). Note that this article could not be located as it seems to be a subscription only journal. Gregory Shaffer, *How to Make the WTO Dispute Settlement System Work for Developing Countries: Some Proactive Developing Country Strategies*, <http://www.ictsd.org/dlogue/2003-02-07/03-02-07-prog.htm>

⁹⁴ See *Chile Looks for Monetary Sanctions as Enforcement Mechanism*, INSIDE U.S. TRADE 13 (Oct. 11, 2002), as quoted by Shaffer, see above. (Once again this source could not be checked)

⁹⁵ *Free Trade With Chile Summary of the U.S.-Chile Free Trade Agreement*
http://www.ustr.gov/regions/whemisphere/samerica/2002-12-11-chile_summary.pdf

⁹⁶ NAFTA Article 1135: Final Award.

“Where a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination, only:
(a) monetary damages and any applicable interest;
(b) restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution.

A tribunal may also award costs in accordance with the applicable arbitration rules.”

These provisions were used in a 2002 dispute, where a NAFTA dispute panel awarded damages of over CDN 6 million (plus interest) to US investor S.D. Myers, resulting from a temporary Canadian government ban on the export of hazardous PCB wastes.

Chapter 11’s conflict resolution procedure is, however, extremely controversial, as it allows investor-to-state dispute settlement. This is a dispute settlement mechanism that goes far beyond anything contemplated under the WTO, and thus is not entirely relevant in the consideration of the present case.

the DSU procedure for determining the level of concessions. Finally, the paper will turn to the question of the relevance of customary international law, and the potential of this to provide adequate remedies to the potential claimant countries.

i. Dispute Settlement Understanding:

In relation to a claim of a breached obligation under the AoA, it is the provisions of the Dispute Settlement Understanding (DSU) that govern the availability of remedies.⁹⁷ The DSU has a highly developed and specific regime for compensation and trade-related mechanisms, as set out in A21 and 22.

Under article 22, compensation is ‘voluntary’ and ‘temporary’.⁹⁸ Although the term ‘compensation’ is not defined in the DSU, nor has the meaning of the term in this context been clearly defined in any WTO case law, it seems the term could easily be construed to include financial compensation, and there is no evidence to suggest otherwise. In fact, as discussed above, the issue of monetary compensation was first raised in the 1960s, and was on the table long before the WTO DSU was under negotiation. Clearly, the issue would have been contemplated during the drafting of these provisions. Thus it would be reasonable to infer, from the absence of an express exclusion of ‘monetary compensation’ from these provisions, an implicit recognition of the potential for ‘monetary compensation’ under these provisions.

However there is a distinct difference between the procedure in relation to ‘compensation’ and that of ‘suspension of concessions’ under article 22. Article 22.1 makes it clear that ‘compensation’ can only ever be voluntary, whereas the ‘suspension of concessions’ can be an enforceable remedy. Article 22.2 allows a party to “request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements”, however there is no equivalent mandate for the DSB to authorize compensation. Therefore if no compensation can be agreed upon between the parties, then, in reality, the only available enforceable remedy seems to be trade-related mechanisms such as retaliation.

It seems that the question put forward in the Pakistani proposal may not be phrased in quite the right manner. Although the term ‘compensation’ may include ‘monetary compensation’, that may not in fact be the crucial issue. What is crucial to developing countries is that compensation should be able to be authorized by a DSB, and thus enforceable. This seems to be the key question, requiring analysis of case law, special and differential treatment and other principles involved in the interpretation of A22.

ii. Case Law:

The issue of monetary compensation has only ever been raised during WTO dispute settlement in relation to the issue of ‘retroactive compensation’. Retroactive compensation formed the basis of a claim by Guatemala in the *Cement Case*; however the Panel denied the legitimacy of such a claim, noting that “no GATT 1947 or WTO panel ever has awarded monetary compensation to an exporting country for lost trade.”⁹⁹

The issue was once again considered by a Panel in a dispute between the US and the EU in 2000. Here, the Panel reiterated the lack of legal basis for claiming monetary compensation:

⁹⁷ A19 of AoA states that AXXII & XXIII of the GATT 1994 shall apply, as elaborated by the DSU.

⁹⁸ DSU A22.1

⁹⁹ Guatemala - Definitive Anti-dumping Measures on Grey Portland Cement from Mexico - Report of the Panel (WT/DS156/R) Para 5.175

“We note ... that the principal object and purpose of DSB authorised suspension of concessions or other obligations is not to obtain monetary compensation for an amount equivalent to the lost trade (caused by the WTO incompatible measure), but rather to restrict trade to an extent equivalent to the trade affected by the incompatible measure. Even in situations of WTO authorised suspensions of concessions, those enterprises that suffer from the consequences of the incompatible measures do not get any form of compensation out of the suspension of concessions. The purpose of such DSB authorised retaliatory measure is not to collect duties to be redistributed to exporters who lost trade opportunities because of the WTO incompatible measure of another Member. The **major purpose** of the WTO compatible suspension of concessions is to involve other interest groups from the Member at fault in order **to induce compliance** of that Member. The ultimate object of WTO authorised suspensions of concessions or other obligations is to remove WTO benefits and, therefore, probably to stop some trade.”¹⁰⁰ (my emphasis)

These comments reflect the legal analysis in the previous section of this paper, which notes that there is no remedy for past wrongs, and “no compensation for the economic harms done by legal violations”.¹⁰¹ Although these limited comments may suggest a strict interpretation of A22, which has, in the past, restricted the availability of monetary compensation as a remedy under the DSU, it is important to analyze the reasoning used by the Panel before coming to a conclusion on the issue.

1. Inducing compliance: past v future injury

In the US/EU case, it is apparent that the Panel perceives the major purpose of A22 as being the involvement of interest groups in order to induce compliance by the offending WTO Member, rather than the collection of duties and redistribution of trade benefits. Furthermore, it seems that the claim for compensation in this case failed on the basis that a monetary award in relation to **past** injury was not available, as it would not fulfill the major purpose of the Article – that is to induce the compliance of the offending Member. In contrast, the present case could be framed as a claim for compensation in relation to **future** injury resulting from the subsidies that are in breach of reduction commitments. Such a claim would not be contrary to the precedent set in the above cases, as ‘monetary compensation’ in relation to future injury would certainly contribute towards the object of inducing compliance of the offending Member.

2. Inducing compliance: influence on interpretation

In addition, the Arbitrators in *EC – Bananas III (Ecuador)* further explored the notion of the object and purpose of Article 22, and used the object of inducing compliance to guide their interpretation of the article.¹⁰² In fact the Arbitrators allowed the more flexible form of retaliation - that is, retaliation under other WTO agreements, rather than that restricted to a specific sector or specific agreement¹⁰³ – on the basis of an interesting interpretation of A22.3. This particular provision allows a more flexible form of retaliation in situations where the party considers that more the specific form of retaliation is ‘not practicable or effective’.¹⁰⁴ Their interpretation of the phrase

¹⁰⁰ United States - Import Measures on Certain Products from the European Communities - Report of the Panel (WT/DS156/R) para 6.82

¹⁰¹ Hudec, Robert, “Broadening the Scope of Remedies in WTO Dispute Settlement”, in Weiss & Weirs (eds.), *Improving WTO Dispute Settlement Procedures*, Cameron May Publishers, 2000, www.worldtradelaw.net/articles/hudecremedies.pdf, p. 34

¹⁰² [Decision by the Arbitrators on EC – Bananas III \(Ecuador\)](#), WT/DS27/ARB/ECU, para 73

¹⁰³ That is to say that retaliation was granted under A22.3(c), rather than A22.3 (a) or (b)

¹⁰⁴ A22.3 reads as follows:

“... (b) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to the same sector(s), it may seek

‘practicable or effective’ is an interesting demonstration of how this object and purpose of inducing compliance can guide interpretation of the provision in general, as explained below.

As noted in legal commentary, the arbitrators in this case “held that the term ‘practicable’ connoted ‘availability’ and ‘suitability’; with respect to the term ‘effective’, the Arbitrators held that ‘the thrust of this criterion empowers the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance by the Member which fails to bring WTO-inconsistent measures into compliance with DSB rulings within a reasonable period of time’.”¹⁰⁵

The Arbitrators also made the following interesting comments on the issue of ‘effectiveness’:

In contrast, the term ‘effective’ connotes ‘powerful in effect’, ‘making a strong impression’, ‘having an effect or result’. Therefore, the thrust of this criterion empowers the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance by the Member which fails to bring WTO-inconsistent measures into compliance with DSB rulings within a reasonable period of time.

One may ask whether this objective may ever be achieved in a situation where a great imbalance in terms of trade volume and economic power exists between the complaining party seeking suspension and the other party which has failed to bring WTO-inconsistent measures into compliance with WTO law. In such a case, and in situations where the complaining party is highly dependent on imports from the other party, it may happen that the suspension of certain concessions or certain other obligations entails more harmful effects for the party seeking suspension than for the other party. In these circumstances, a consideration by the complaining party in which sector or under which agreement suspension may be expected to be least harmful to itself would seem sufficient for us to find a consideration by the complaining party of the effectiveness criterion to be consistent with the requirement to follow the principles and procedures set forth in Article 22.3.

...

Our interpretation of the ‘practicability’ and ‘effectiveness’ criteria is consistent with the object and purpose of Article 22 which is to induce compliance. If a complaining party seeking the DSB’s authorization to suspend certain concessions or certain other obligations were required to select the concessions or other obligations to be suspended in sectors or under agreements where such suspension would be either not available in practice or would not be powerful in effect, the objective of inducing compliance could not be accomplished and the enforcement mechanism of the WTO dispute settlement system could not function properly.¹⁰⁶

The arguments used by the Arbitrators to allow the more flexible form of retaliation would be equally applicable to an argument to further broaden the remedy from one of retaliation, to one of monetary compensation.

to suspend concessions or other obligations in other sectors under the same agreement;
 (c) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to other sectors under the same agreement, and that the circumstances are serious enough, it may seek to suspend concessions or other obligations under another covered agreement;...”

¹⁰⁵ WTO Analytical Index, *Understanding on Rules and Procedures Governing the Settlement of Disputes*, at http://www.wto.org/english/res_e/booksp_e/analytic_index_e/dsu_08_e.htm#articleXXIIB3a

¹⁰⁶ *Decision by the Arbitrators on EC – Bananas III (Ecuador) (Article 22.6 – EC)*, paras. 70-73 and 76

As highlighted in previous section 4(a)(i), trade sanctions are impractical for the claimant countries due to their lack of other export products, the preferential access other products already receive, and the lack of ability to increase customs tariffs on imports.¹⁰⁷ Trade sanctions are also ineffective in inducing compliance due to the small market share they possess. Therefore in order to induce compliance by the offending member, and uphold the object and purpose of A22, action other than trade sanctions is undoubtedly required. Given that monetary compensation seems to be the only potential way of inducing compliance, then perhaps this would be a strong argument in favour of a broader interpretation of A22.

iii. Special and Differential treatment:

The DSU contains provisions which acknowledge that developing countries' interests should be taken into account in a WTO determination, particularly in articles 21.2, 21.7 & 21.8.

Article 21.2 states that particular attention should be given to matters affecting the interests of developing countries in the procedures designed to ensure the implementation of recommendations and rulings. This provision was invoked by Argentina and Chile in arbitration procedures on the length of the reasonable period of time for the implementation of DSB recommendations and rulings.¹⁰⁸ As a commentator has noted,

“The arbitrator recognised that this provision, though cast in general terms, "is not simply to be disregarded" because "it is in the DSU". However, in both cases he declined to apply it on the ground that Argentina and Chile had not been very specific about **how their interests as developing countries actually bear upon** the duration of the implementation period.”¹⁰⁹ (my emphasis added)

In *Indonesia – Automobile Industry*, the arbitrator used Article 21.2 as the legal basis for an extension of the implementation period by six months.¹¹⁰ The Arbitrator, in determining the “reasonable period of time”, took into account not only Indonesia’s status as a developing country, but also the fact that “it is a developing country that is currently in a dire economic and financial situation”.¹¹¹

The Arbitrator used the following language to justify this conclusion:

Although the language of this provision is rather general and does not provide a great deal of guidance, it is a provision that forms part of the context for Article 21.3(c) of the DSU and which I believe is important to take into account here. Indonesia has indicated that in a ‘normal situation’, a measure such as the one required to implement the recommendations and rulings of the DSB in this case would become effective on the date of issuance. However, this is not a ‘normal situation’. Indonesia is not only a developing country; it is a developing country that is currently in a dire economic and financial situation. Indonesia itself states that its economy is ‘near collapse’. In these very particular circumstances, I consider it appropriate to give full weight to matters affecting the interests of Indonesia as a developing country pursuant to the provisions of Article 21.2 of the DSU. I, therefore,

¹⁰⁷ TN/AG/GEN/4, para 37

¹⁰⁸ Arbitration under Article 21.3(c) of the DSU, *Chile – Taxes on Alcoholic Beverages*, WT/DS887/15-WT/DS110/14, para. 45 and Arbitration under Article 21.3(c) of the DSU, *Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, WT/DS155/10, para. 51.

¹⁰⁹ Frieder Roessler, *Special and Differential Treatment of Developing Countries under the WTO Dispute Settlement System*, p. 4, <http://www.ictsd.org/dlogue/2003-02-07/Roessler.pdf>

¹¹⁰ Arbitration under Article 21.3(c) of the DSU, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/15- WT/DS55/14- WT/DS59/13- WT/DS64/12, para. 24.

¹¹¹ *Indonesia – Certain Measures Affecting the Automobile Industry*, para. 24.

conclude that an additional period of six months over and above the six-month period required for the completion of Indonesia's domestic rule-making process constitutes a reasonable period of time for implementation of the recommendations and rulings of the DSB in this case.¹¹²

This paper will highlight the potential importance of this precedent below.

This appears to have been the only practical impact of A21.2 so far. However in addition to this, similar provisions exist in articles 21.7 and 21.8, according to which the DSB shall take into account the interests of developing countries in its task of surveying the implementation of recommendations and rulings. As Roessler notes, "the DSB has never applied these provisions and was never requested to do so".¹¹³

Article 21.7 states that in matters raised by a developing country, "the DSB shall consider what further action it might take which would be appropriate to the circumstances". Although it is not clear what this 'further action' might include, one could argue that this provides a basis for authorizing monetary compensation rather than trade sanctions in appropriate circumstances. This formed the basis of the African proposal on the DSU review,¹¹⁴ and seems to have a fairly strong legal foundation. It seems that an assessment of what "would be appropriate to the circumstances" would involve consideration of the 'effectiveness and practicability' of the remedies currently available to the claimants. As examined above, one would have to conclude that retaliation is not an effective or practicable remedy for the claimant countries, and as such 'further action' such as monetary compensation is justified.

Similarly, article 21.8 notes that the impact on the economy of a developing country should be taken into account. Therefore, in line with the reasoning in the *Indonesian* case, one could argue that the DSB must also consider the claimants' dire economic and financial situations, and their dependence on cotton. As outlined in submissions to the WTO, the claimant countries are in particularly bad economic positions as a result of the US cotton subsidies. More than 10 million people depend directly on cotton production, and these producers are losing out as a result of US cotton subsidy programs.¹¹⁵ The claimant countries are losing about 10% of their export earnings due to these subsidies.¹¹⁶ These losses have "generated acute balance of payments and domestic budget pressures, and have pushed [them] to the brink of a renewed debt crisis".¹¹⁷ It seems clear that this dire economic situation could further justify the need for monetary compensation rather than the remedy of retaliation.

Although the interpretation in favour of enforceable monetary compensation would be a rather radical departure from the 'strict' legal interpretation currently given to A22, as discussed above, there is certainly a basis for arguing for this departure based on the special considerations the DSB must take into account under articles 21.7 & 21.8.

¹¹² Ibid.

¹¹³ Frieder Roessler, *Special and Differential Treatment of Developing Countries under the WTO Dispute Settlement System*, p. 4, <http://www.ictsd.org/dlogue/2003-02-07/Roessler.pdf>

¹¹⁴ African Group Proposal on DSU, (TN/CTD/W/28) 14 February 2003, para titled "Article 21.2, 21.7 and 21.8"

¹¹⁵ *Poverty Reduction: Sectoral Initiative in favour of Cotton*, Joint Proposal by Benin, Burkina Faso, Chad and Mali (TN/AG/GEN/4), para 1

¹¹⁶ Oxfam Briefing Paper, *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*, 2002, at http://www.oxfam.org/eng/pdfs/pp020925_cotton.pdf, p. 3

¹¹⁷ Oxfam report, p. 3

iv. Object and Purpose of Treaty:

Article 3.2 of the DSU requires that the “customary rules of interpretation of public international law” must be taken into account. It is an established principle of customary international law that a treaty must be interpreted in light of its object and purpose.¹¹⁸ As confirmed in the Shrimp/turtles decision, “where the meaning imparted by the text itself is equivocal or inconclusive, or where confirmation of the correctness of the reading of the text itself is desired, light from the object and purpose of the treaty as a whole may usefully be sought”.¹¹⁹

Thus in interpreting the provisions of the DSU, the ‘object and purposes’ of the WTO as a whole must also be taken into consideration. As one scholar points out “it is not the WTO's mandate to deal with all inequalities between players which pre-existed the WTO contract ... It is the WTO's mandate, though, to ensure that, with respect to its quintessential function - the adjudication of disputes - all necessary steps will be taken to guarantee that inequalities will not adversely affect the rights of the states concerned”.¹²⁰

From this more general perspective, it could also be argued that it would be manifestly unfair for the claimant countries as LDCs to be left without an effective remedy under the DSU, as this would be an inequality in the adjudication of a dispute – something which is contrary to the objects and purposes of the WTO itself. This could potentially be another legal argument for supporting a more liberal interpretation of A22, allowing the imposition of monetary compensation by the DSB.

v. Relevance of Customary International Law:

In assessing the legal basis for compensation, the relevance of customary international law for WTO law must also be taken into consideration. In order to do this, one must closely examine the law of ‘lex specialis’ and ‘self-contained regimes’. Although it is possible to argue that the WTO should be construed as a ‘self contained’ regime and hence insulated from general public international law, this has the support of neither the commentators nor the WTO Appellate Body, as examined below.

Mavroidis, a distinguished scholar on the issue, notes that “the WTO Appellate Body took significant steps in construing the WTO contract not as a ‘self contained’ regime in the recent *Shrimps-Turtles* litigation between the United States and a number of shrimp exporters to the US market”.¹²¹ He suggests that as a result of the law of ‘lex specialis’,¹²² customary international law will apply only to the extent that a particular treaty regime does not contain specific provisions dealing with the issue of remedies.¹²³ Although Mavroidis notes that the WTO regime under the DSU is “vague on this issue”, he makes a convincing argument that “Article 19(1) DSU does not prejudice the form of remedies that the WTO adjudicating bodies can suggest”.¹²⁴

¹¹⁸ Article 31(1) of the Vienna Convention on the Law of Treaties states that a “treaty shall be interpreted in good faith in accordance with the ordinary meaning given to the terms of the treaty in the context and in light of its object and purpose”

¹¹⁹ WT/DS58/AB/R, 12 October 1998, para 114

¹²⁰ Petros C. Mavroidis, Remedies in the WTO Legal System: Between a Rock and a Hard Place, 11(4) *EJIL*, 763, at 808 (Footnote 134)

¹²¹ Petros C. Mavroidis, Remedies in the WTO Legal System: Between a Rock and a Hard Place, 11(4) *EJIL*, 763, at 765

¹²² A37 of ILC Draft Articles on State Responsibility

¹²³ Mavroidis, at 765

¹²⁴ Mavroidis, at 765

Once the applicability of customary international law is established,¹²⁵ one must next turn to how this applies to a potential breach of the AoA. The AoA takes the form of an international treaty, and, consequently, acts committed in violation of its provisions are “internationally wrongful acts” under customary international law. In the area of State Responsibility, customary international law has been codified by the ILC, in the form of the Draft Articles on State Responsibility for internationally wrongful acts.¹²⁶ According to the ILC draft articles, a state which is the author of an illegal act has two obligations: (1) an obligation to stop the illegal act; and (2) an obligation to provide a form of reparation to the injured party(ies).¹²⁷

Therefore irrespective of the remedies available under the DSU, a violation of the AoA provisions in the form of illegal cotton subsidies would be an internationally wrongful act. Therefore the countries in breach of their commitments under the AoA would have an obligation to provide reparation to the claimant countries under ILC draft article 42. This would be another possible legal foundation for the claim for monetary compensation, however there seems to be no legal precedent for this use of customary international law in trade disputes at this stage.

c. Potential Law Reform

There have been various proposals for reform to the DSU in order to develop a more solid legal foundation for monetary compensation. The LDC group has proposed that “compensation under Article 22.2 should be made mandatory by the elimination of the phrase *‘if so requested’* in that paragraph”.¹²⁸ The intent of this reform is certainly in line with the reasoning in this paper, however it is questionable whether such a reform would resolve the crucial issue. A22.2 relates to negotiated settlements, rather than DSB mandated remedies, so even if the phrase *‘if so requested’* was to be removed, this would still not give the DSB the mandate to authorize compensation. Similarly, this would still conflict with the terms of A22.1, which states that “compensation is voluntary”.

The reform proposal by the African group focuses on the interpretation of A21.7. In line with this paper’s legal argument, presented above, their proposal promotes an interpretation that allows “the developed country Member [to] pay monetary compensation or make some other form of compensation to the developing country Member”.¹²⁹ This proposal is certainly valid, however in order to provide a more solid legal solution to this problem, the claimant countries may wish to propose a more specific reform of the DSU, for example by adding a new article following the current A22.3(c), which could read:

A22.3(c) (bis):

In matters raised by a developing country, where the party considers that it is not practicable or effective to use the above mechanisms of trade retaliation due to a special disadvantage or vulnerability (including a commodity-dependence), the party may request authorization by the DSB of a monetary compensation as an alternative remedy.

¹²⁵ For the current purposes, I will assume that Mavroidis’ analysis is correct, however further analysis on this issue may be prudent.

¹²⁶ Although the form of the articles has not yet been finalized, it is clear that the current draft has persuasive force, as international adjudicating bodies have already been inspired by these draft articles. See Petros C. Mavroidis, at 767

¹²⁷ Draft articles 41 & 42, as explained by Mavroidis, at 767

¹²⁸ Negotiations on the Dispute Settlement Understanding, Proposal by the LDC Group (TN/DS/W/17), para 13

¹²⁹ African Group Proposal on DSU, (TN/CTD/W/28) 14 February 2003, para titled “Article 21.2, 21.7 and 21.8”

This new provision would retain the same elements of practicality and effectiveness as required for the broadening of the scope of retaliation under subsections (b) and (c), as well as incorporating the special treatment as envisaged by A21.7. The authorization of monetary compensation would be restricted to situations where trade retaliation is not practicable or effective.

5. Conclusion:

As examined in the first section of this paper, the claimants would have to establish a cause of action based on a breach of a specific reduction commitment under the AoA, rather than a breach of a general principle of free trade. This paper has shown that even though there have been massive increases in the total amount of subsidies granted to cotton growers (particularly in the US), this does not necessarily mean that specific legal obligations such as the AMS reduction commitments have been breached. This fact demonstrates the fundamental need for reform in the categorization of subsidies under the AoA, to ensure that developing countries benefit from the promised subsidy reductions. There remains the potential of establishing breaches under certain provisions, particularly in relation to the 2002 Farm Bill, however further research is required before assessing the validity of such a claim. Many complex questions of subsidy classification are raised in this area, and the pending Panel decision in the *Brazil – US cotton subsidies* case may provide clarity on many of these issues.

The issues of causation and the quantification of damages raise additional complex legal and economic questions. This paper has examined the link between subsidies and the claimants' injury, however many questions remain unanswered in this area. It has been demonstrated that retroactive compensation has no valid legal basis, however could still be pursued from a moral and political standpoint in compensation negotiations.

Finally, the paper highlights the uncertain legal foundation of the remedy of monetary compensation. Although the granting of monetary compensation may be quite a serious departure from the self-enforcing trade retaliation mechanisms so far employed by the DSB, this paper has shown that such a departure can be warranted from both a legal and political perspective. Monetary compensation has been recognized as a suitable remedy within both bilateral and multilateral trade agreements, and has also proven successful in other international forums (such as the ECJ).

The claimants have a reasonable legal argument for monetary compensation on the basis that the traditional remedy of trade retaliation will not be a 'practicable and effective' way to induce compliance (the object and purpose of A22). Further, it could be argued that a DSB must take into account the fact that the claimant countries have a special disadvantage as commodity-dependent LDCs (pursuant to A21.7), as well as their dire economic and financial situations (pursuant to A21.8 and the reasoning of the *Indonesian* case). For these reasons, the DSB may potentially have the legal mandate to take 'further action' (A21.7) such as authorizing monetary compensation instead of trade retaliation. In addition, customary international law could provide an alternative legal basis for recovering monetary compensation.

Finally, the paper provides analysis of the reforms proposed by the various groups on the issue, and concludes with a law reform suggestion that would establish a more firm legal foundation for the remedy of monetary compensation.

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