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CONTRIBUTION OF ECUADOR TO THE IMPROVEMENT OF THE DISPUTE SETTLEMENT UNDERSTANDING OF THE WTO

Communication from Ecuador

The following communication, dated 28 June 2002, has been received from the Permanent Mission of Ecuador.

The experience of the banana dispute confronted the Members of the WTO with a number of unprecedented situations that drew attention to serious shortcomings in the DSU and disclosed systemic flaws in the dispute settlement mechanism that put its credibility at risk.

The most important of these aspects is undoubtedly the sequence of Articles 21.5 and 22 of the DSU. Progress has been made since 1999 with a proposed amendment co-sponsored by 14 Members of the WTO, including Ecuador, which we will refer to as the co-sponsors' proposal. Pursuant to the mandate given in the Doha Ministerial Declaration and the progress made, this proposal represents a major contribution to clarifying and improving the DSU by May 2003.

It only represents an initial stage in resolving the sequence issue, however, even though it suggests mechanisms to determine compliance and terminate the procedure, because it does not touch on a substantial part of the effectiveness of the so-called "last resort" aimed at achieving "prompt compliance". It is thus a very important modification albeit incomplete because the very essence of the sequence is directly linked to prompt compliance. The draft amendment clarifies the procedure for initiating implementation of the last resort, namely suspension of concessions, but does not propose ways of improving the effectiveness of this instrument, which has proved to be of little use.

Along the same lines, we should like to share with members some thoughts regarding how the last resort in the system could be improved in order to foster prompt compliance, which is the cornerstone of the DSU's credibility.

Basic elements of the DSU

In order to put our proposal in context, it is necessary to recall the basic principles underpinning the dispute settlement mechanism, which are set out in the General Provisions of Article 3 of the DSU as follows:

(a) To provide security and predictability to the multilateral trading system;

(b) prompt settlement;

(c) settlement that is compatible with the covered agreements;

(d) preference to be given to mutually acceptable solutions;

(e) voluntary compensation should only apply if the immediate withdrawal of the measure is impracticable;

(f) the last resort is the possibility of suspending the application of concessions subject to authorization by the DSB;

(g) presumption of nullification or impairment;

(h) good faith, it being understood that use of the dispute settlement procedure is not intended or considered to be a contentious act;

(i) special attention should be paid to the problems and interests of developing country Members.

Consequently, there needs to be fair and adequate strengthening so as to find better ways of achieving prompt compliance. This means that the purpose of strengthening must not be to punish the Member that is the subject of the complaint but to achieve a prompt settlement when all prior procedures have been exhausted.

Time-frame and effectiveness of last resort

It is important to highlight the time-frame for compensation and withdrawal of concessions, provided in Article 22.1 of the DSU, in order to reach a better understanding of how to promote their implementation. It must be borne in mind that the basic objective is to allow the multilateral system to eliminate a measure that weakens it and to ensure that payment of compensation does not result in continued violation of the system. The purpose is also to ensure that the suspension of concessions has the effect of ending the inconsistency and is not to make retaliation so ineffective that non-compliance with the system can continue indefinitely or that obligations are not even suspended because this would cause even greater injury to the economy of the complaining Member.

It is sensible to seek more effective implementation of retaliation that does not involve suspending concessions because, by their very nature, trade relations work both ways, with one party importing and another exporting, so suspension would injure the economic agents of the complaining party who have nothing to do with the dispute, as occurred in the banana dispute with the United States. This did not happen in Ecuador precisely because it did not apply the retaliation measures authorized by the DSB.

The problem, therefore, is not that a developing country cannot take retaliatory measures but that they were not effective in the case of the most developed economy in the world. In the banana dispute, despite the withdrawal of concessions, the party concerned took a further 30 months to comply with the ruling after the expiry of the reasonable period of 15 months established by the DSB and easily withstood 27 months of retaliatory measures.

It is useful to refresh one's memory regarding this ineffectiveness, recalling that the only suspension of obligations authorized by the GATT Contracting Parties in 1952 in favour of the Netherlands against the United States was not implemented either. Mention could also be made of the recent disputes on beef hormones and aircraft export subsidies, in which there was no "prompt compliance" either despite the time that elapsed.

It should also be noted that on the two occasions on which concessions were suspended their time-frame was not on the agenda so the complaining party invoked the carousel provision in order to rotate sanctions, essentially not in order to punish the party concerned twice over, as was generally assumed, but to help its traders who had suffered serious economic injury. There are also other cases in which obligations were not suspended because it was clear from the outset that suspension would not ensure prompt compliance.

The alternative to compensation

The procedure prior to the last resort is compensation, but as it has been considerably weakened it could not even be considered as the "penultimate" resort. This is obvious from the fact that, to date, there have been very few cases in which it has been approved and applied, even unofficially, because the DSB has not been officially informed of its application. This exception confirms the rule that compensation is simply an embellishment of the system and Members prefer not to apply it because it is not beneficial to any party. The incentive for granting compensation would be to avoid the last resort, but as it is not very effective it is obvious that there is no interest in applying it. It is hardly realistic to pay in order to avoid something that does not function or, as occurred in those few cases in which compensation was approved to pay but not achieve compliance.

It is now time to consider the basic objective of compensation, which is also to restore the balance between the benefits and obligations that changed as a result of the inconsistent measure, because this does not only involve the suspension of concessions. The essential difference between compensation and retaliation is that one is voluntary and the other mandatory, but the two share similar objectives, namely, to encourage prompt compliance and temporarily restore the balance in the mutual obligations of the complaining party and the party that is the subject of the complaint, as well as the inviolability of the multilateral system.

This situation makes it necessary to strengthen the application of compensation so as to prevent a system of retaliation which in trade relations is not an eye for an eye or a tooth for a tooth and does not restore the balance lost, nor does it encourage compliance, but rather tends to inflict greater injury on the complaining party, as occurred in the banana dispute.

Negotiation is the most appropriate instrument for reaching solutions until full compliance comes into effect, consequently, the possibility of negotiating a compensation package must be preserved at all stages of the sequence in which compliance is at risk.

The most appropriate approach would be to give compensation all it needs to become viable. There should be a first stage in which compensation is voluntary but based on the panel's valuation of the nullification or impairment caused to the complaining party. In order to remain consistent with the main objective of prompt compliance, the mandate or terms of reference on arbitration set out in Article 21.3(c) of the DSU should be broadened, by determining an annual level of nullification or impairment in addition to fixing a reasonable period of time for prompt compliance.

Just as implementation of Article 21.3 serves to determine the reasonable period, by means of an amendment to its provisions the Member concerned could propose the annual level of nullification or impairment when determining the reasonable period according to Article 21.3(a) or when it is mutually agreed by the parties, Article 21.3(b). In the absence of agreement, the arbitration referred to in Article 21.3(c) would apply.

If differences between the parties regarding the consistency of the compliance measures with the covered agreements still remain at the end of the reasonable period, this disagreement would be resolved through recourse to a panel that would verify compliance, as proposed in Article 21 *bis* of the co-sponsors' proposals.

If this panel finds that the recommendations adopted by the DSB have not been complied with, at the time of adoption of the report of the panel that verified non-compliance the Member concerned must propose a compensation package equivalent to the level of nullification or impairment suffered by the complaining party. The level is already known because it was determined by the arbitrator when the reasonable period was established.

In this connection, the provisions of Article 22 of the DSU could be implemented either through voluntary compensation within 20 days following the expiry of the reasonable period or, in cases of disagreement on the implementation of the compliance measures, at the time of adoption of the report of the panel which concluded that there had been non-compliance.

Regarding the type of compensation, the Member concerned could offer a package of trade benefits or any other form of compensation that does not affect other Members under the agreements concerned. For developing countries, the MFN clause could be waived temporarily in order to allow compensation.

If no agreement can be reached despite all these measures, there is no other alternative but to use the last resort.

Last resort

Implementation of Article 22 of the DSU would be allowed subject to the following criteria:

(a) There is no disagreement regarding the fact that the Member concerned has not complied;

(b) compensation has not been granted; and

(c) if there is disagreement regarding non-compliance, the panel has found that the party concerned did not comply with the DSB's recommendations.

At this stage, it has to be recognized that prompt compliance has been an illusion and it is now simply a case of achieving compliance "in extremis". If we also bear in mind the fact that all the disputes that have reached this point have not achieved compliance or have with difficulty achieved delayed compliance, it becomes obvious that the last resort needs to be modified.

In order to understand the new situation fully, we should emphasize that the device of not allowing a new period for compliance is yet another concern because a party reluctant to comply with the DSB may take another totally illegal but perfectly feasible period that greatly exceeds the reasonable period that has already expired.

Because compensation must be viable as it is preferable to the suspension of concessions, the Member concerned must be discouraged from deciding to avoid compliance and accepting the alternative of retaliation, especially when the complaining Member is a developing country.

Ecuador therefore proposes that Article 21.8 of the DSU, which contains a compulsory provision on special and differential treatment, be made more effective and authorize developing countries, when they suspend concessions to a developed country, also to take into account the impact on their economies and not only on the level of nullification or impairment.

The level of nullification or impairment determined in the arbitration should be multiplied by a factor that is at least twice the amount authorized by the DSB for the suspension of concessions or other obligations.

Another alternative to be considered would be the possibility of making compensation compulsory, so it would become a sanction imposed by the multilateral system on Members that fail to comply with their obligations.

Instead of authorizing the suspension of concessions or other obligations, the DSB, when adopting the report of the panel responsible for verifying compliance, could decide that the Member concerned must obligatorily compensate the complaining party. The non-complying Member must submit a compensation package to the next session of the DSB for its approval. If the Member concerned submits such a proposal to the DSB, the latter would adopt it if it covers the amount of the nullification or impairment, in conformity with the verification to be carried out by the WTO Secretariat. If no compensation package is submitted, on the assumption that it is acting in good faith, it will be understood that the Member concerned intends to compensate in cash and the DSB will decide, unless otherwise agreed by consensus, that it should immediately pay in cash an amount equivalent to the value of the nullification or impairment determined during arbitration as of the date of expiry of the reasonable period for prompt compliance and will determine the corresponding monthly amount to be paid for a maximum period of six months until the Member concerned meets its obligations to the DSB.

If compensation is made compulsory, it becomes a sanction, but not of the same nature as the suspension of concessions or other obligations because these do not restore the balance lost in bilateral and multilateral trade relations. Retaliation leads to the temporary waiver of certain WTO Agreements in favour of the complaining party, which affects the whole system and not only the Member concerned, or 100 per cent are fixed tariffs, even though these did not previously exist in trade between the two parties to the dispute. This disproportionate effect makes retaliation ineffective and turns it into a boomerang for the Member that adopted the measure.

Compensation, on the other hand, restores the trade balance and does not suspend implementation of certain multilateral commitments in favour of the complaining party. As its name suggests, it means giving something equivalent to the nullification or impairment but without affecting the implementation of the system or jeopardizing the economic interests of trade operators who have nothing to do with the dispute and belong to both parties to it.

In order to achieve the essential objective of compliance, it is necessary to ensure that compensation does not become a way of paying in order to maintain a situation of non-compliance. This objective can be achieved by providing that compensation should be paid for a period of six months, after which the DSB will have no other alternative but to consider extreme measures.

In conclusion, the last resort would no longer be the suspension of concessions or other obligations but compulsory compensation after sufficient time has been given for compliance and for the negotiation of compensation on the basis of the adequate valuation of nullification or impairment made during arbitration, with the additional advantage of providing a new maximum reasonable period of six months during which the Member concerned must necessarily pay compensation.

If the Member concerned still does not comply after being given such a broad range of possibilities, in order to preserve the mechanism's credibility, there is no alternative but to impose stricter conditions in order to encourage compliance through suspension of the right of the Member concerned to invoke the DSU or authorize large-scale retaliation.

Final comments

It is true to say that, in general terms, the dispute settlement mechanism operates satisfactorily. It is equally true that it constitutes the most precious jewel in the crown of the multilateral trading system, precisely because in the former GATT it finally became an ineffective tool because the conclusions and recommendations of panels were not even adopted. This mechanism is undoubtedly a fundamental element in the WTO system's credibility. It is also true, however, that all the positive elements are to be found in the new part of the regime incorporated into the DSU, in other words, the negative consensus for the adoption of the DSU's recommendations is based on the consideration that weakening the obligations laid down in the WTO Agreements is a multilateral and not a bilateral matter.

The fact that the mechanism functions does not inevitably lead to the conclusion that the DSU is sacred and virtually perfect, and therefore does not need to be modified. This statement is not correct because the Members themselves at the Doha Ministerial Conference decided by consensus that the DSU should be improved and clarified. What needs to be pointed out, however, is that this improvement could lead to a deterioration if the aim is global reform or the introduction of changes to aspects that have been functioning satisfactorily. It is perfectly clear that it is a good system but it suffers from an obvious systemic shortcoming relating to the sequence. The sequence proceeds satisfactorily up to a certain point, but from thereon the system becomes weaker and jeopardizes its credibility, although not all disputes reach this stage. Consequently, this should be the focus for the efforts to make the DSU much better and clearer.

Ecuador considers that the co-sponsors' proposal resolves almost all the issues in the sequence problem, although it leaves open the fundamental question of achieving prompt compliance. The ideas set out are aimed at achieving the required strengthening, but we must recognize that, in the long run, compliance cannot be guaranteed because it will always depend on the goodwill of the Members concerned. Nevertheless, compliance should be given more encouragement and, for this purpose, compensation could be an extremely useful tool. The suspension of concessions or other obligations, which is based on the principle of an eye for an eye and a tooth for a tooth, is commercially disruptive and acts against the objectives of the multilateral trading system. Nevertheless, however necessary and ineffective, it remains the last resort of an imperfect system.