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9-4

**The WTO Dispute  
Settlement Mechanism  
and Developing  
Countries: The Brazil–  
U.S. Cotton Case**

By:

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## Executive Summary

The Dispute Settlement Mechanism (DSM) of the World Trade Organization (WTO) is often seen as one of the major achievements of the multilateral trading system. Many believe that the WTO DSM has introduced greater “legalism” and provides a more “rules-oriented” system relative to the “power-oriented” one of the General Agreement on Tariffs and Trade (GATT). Indeed, since its inception in 1995, more and more developing countries have used this system to pursue their trading rights. More important, trade disputes recently resolved through the WTO DSM have involved successful challenges, by developing countries, to certain unfair trade practices of developed countries, including the Brazilian challenge to U.S. cotton subsidies.

Cotton production and trade are highly distorted by policy. Since the late 1990s cotton subsidies in the United States have been frequently criticized for driving down world prices. The continued depression of the world cotton price has made this commodity a hot spot of agricultural trade disputes at the WTO. Citing injury to its domestic cotton industry, Brazil initiated a dispute settlement accusing the United States of provoking and maintaining WTO-inconsistent domestic and trade policies. Relative to the size of national economies, some African countries have suffered far more, but their voice was rarely heard at the WTO DSM.

The reluctance of poorer nations to use the WTO DSM to challenge their richer trading partners raises a number of interesting issues. Most fundamentally, it reflects a long-recognized fact that economic and political power still plays an important role in today’s world trading system. Because of developing countries’ lack of financial, institutional, and human resources, they may find the barriers to using the WTO DSM prohibitively high. For those who manage to enter the DSM or even legally win a case, benefits remain elusive because they can hardly force the losing defendants into compliance. In addition, developing countries risk retaliatory action by rich countries whose trade policies are challenged. This risk is particularly great for the African countries, which are highly dependent on foreign aid from developed countries.

Several policy options are offered to address these issues. One way of increasing developing-country

access to the DSM is to reduce litigation costs, either by using the legal aid currently offered through the Advisory Centre on WTO Law (ACWL) or by introducing some tailor-made and less-demanding litigation procedures for “small claims.” A mechanism for collecting trade data and the formation of a permanent panel could further reduce dispute settlement costs. During the panel ruling implementation stage, developing countries can build on their retaliatory power by further liberalizing their domestic markets and increasing the export stake of developed countries. Forging alliances with constituencies within the developed countries provides an effective strategy that not only strengthens developing countries’ retaliatory power, but also helps them avoid possible political repercussions from the losing party.

Your assignment is to propose changes in the WTO DSM that would benefit small, low-income developing countries.

## Background

### The Dispute Settlement Mechanism in the WTO

The inception of the WTO in 1995 was accompanied by a collection of procedural changes to the GATT. One aspect that has received a great deal of attention is the newly designed DSM. This unique mechanism for the settlement of disputes establishes a formal and mandatory set of procedures intended to prevent the detrimental effects of unresolved international trade conflicts. More important, it helps to mitigate the imbalances between stronger and weaker players by making the resolution of disputes a matter of law rather than power. Most people consider the DSM to be one of the major achievements of the Uruguay Round, and since 1995 it has gained practical importance as members have frequently resorted to using this mechanism.

The WTO’s DSM is governed by the Dispute Settlement Understanding (DSU), which is effectively an interpretation and elaboration of GATT Article XXIII. There are four phases in the DSM: the consultations, the panel, the appellate review, and the implementation. The DSM starts with

consultations, in which a complainant country communicates with a defendant country on the latter's disputable trade measure(s). The two parties have 60 days to consult for a mutually satisfactory solution to the dispute. If no solutions are worked out, the complainant can request a panel proceeding.<sup>1</sup>

The dispute settlement panel meets with concerned parties and other countries (third parties) that notify the WTO of a "substantial" interest in the case. It then prepares an interim report, offering both sides an opportunity to make comments and clarification. The two parties can negotiate a settlement at this point. If no settlement is made, the panel issues its final report (ruling), which is then adopted by the DSB. The complainant, the defendant, or both can appeal; and when this occurs, the dispute settlement case moves to the Appellate Body (AB).<sup>2</sup> The AB upholds or overturns the panel ruling in whole or in part and the AB's decision is final.

If AB ruling favors the defendant, the case typically ends; otherwise, the dispute settlement proceeds to the implementation stage.<sup>3</sup> During this stage, the panel or the AB, calls for the defendant to bring its measures into accordance with its WTO obligations. If the complainant believes that the defendant has not taken appropriate steps, it can subsequently request a "compliance" panel. This panel must determine whether the defendant's efforts have, in fact, brought its measure(s) into compliance. If not, the complainant can ask the DSB for permission to "retaliate" against the defendant. Retaliation typically involves suspending concessions or other WTO obligations to the defendant.

### How Developing Countries Have Fared in the DSM

During the first five years of DSM operation (1995–1999), the European Union (EU) and the United States made extensive use of the mechanism. Of the 185 consultation requests made from 1995 through 1999, the United States and the EU accounted for

60 and 47, respectively, or a combined 59 percent of all requests (Davey 2005). Despite their greater representation in the WTO membership, developing countries only initiated 46 requests (about 25 percent) during this period.

Between 2000 and 2004, the DSM was marked by a noticeable decline in consultation requests—a total of 139 requests. More significantly, the EU and the United States were no longer the dominant complainants in the system. During this period the EU and the United States files only 40 consultation requests, accounting for less than 30 percent of all requests. In contrast, developing countries' use of the system increased dramatically during this period. Altogether, they initiated around 60 percent of consultation requests. Brazil, Argentina, and India were particularly active, initiating 9, 7 and 6 consultation requests, respectively. Thus, in the past few years developing countries have become more frequent users of WTO dispute settlement, both in absolute and in relative terms.

More important, trade disputes recently resolved through the DSM have involved successful challenges, by developing countries, to certain basic policies of the developed countries—for example, India's challenge to the EU's Generalized System of Preferences (GSP) scheme (DS246), a multiparty challenge led by Brazil to the EU sugar program (DS265), and Brazil's challenge to U.S. cotton subsidies (DS267). These cases, and a few others, have directly or indirectly influenced the ongoing Doha Development Agenda negotiations and concluded in a direction toward fairer trade between the North and the South.

The importance of this development, however, should not be overemphasized because it has long been argued that the WTO DSM is too complicated for developing countries to make effective use of it. Apart from the countries mentioned, most developing countries and all least-developed countries have remained silent since the creation of the WTO DSM. For those that have participated and won legal victories through the DSM, it remains to be seen whether they will actually benefit from those favorable rulings.

### The World Cotton Problem

Average cotton stocks in the world have been higher since the late 1990s than in earlier periods

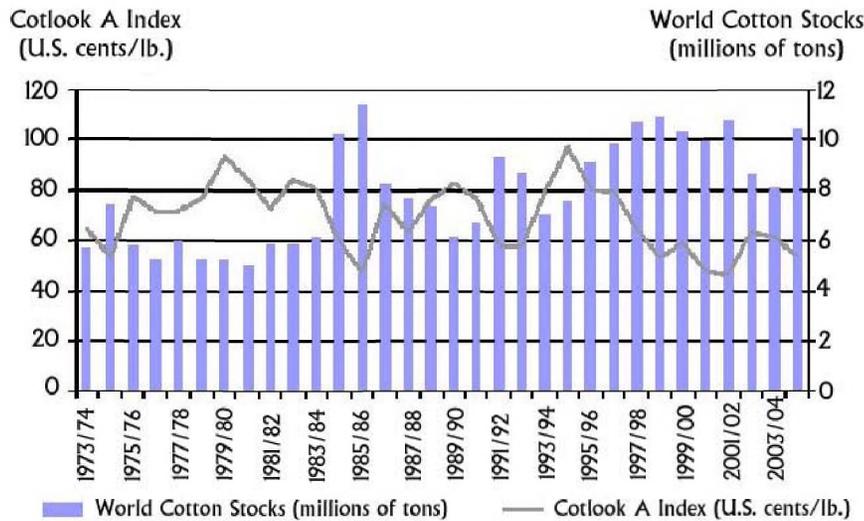
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<sup>1</sup> Panels are established by the Dispute Settlement Body (DSB) and are usually composed of three (possibly five) experts from different countries, agreed to by the parties on a case-by-case basis.

<sup>2</sup> Unlike panels, the AB is a standing body of jurists that is designed to ensure greater consistency across rulings.

<sup>3</sup> The implementation stage can also follow the panel stage if there is no appeal.

Figure 1: World Cotton Stocks and Prices, 1973/74–2004/05



Source: UNCTAD 2006.

(Figure 1).<sup>4</sup> The rise in cotton stocks is attributable to excess supply, notably in China and the United States, where government incentives have stimulated production. Oversupply of cotton has caused a downward pressure on prices.<sup>5</sup> Cotlook A index, a frequently cited cotton reference price, declined consistently during this period, bottoming at 46 U.S. cents/lb. in 2002, compared with a peak of 97 cents/lb. in 1995.<sup>6</sup> Following a meager upward movement in 2003 (63 cents/lb.) due primarily to

a temporary increase in world imports, the Cotlook A index dropped again in 2004 and 2005 (61 cents/lb. and 55 cents/lb., respectively).

In 2001/2002, in the midst of an unprecedented sharp price slump, U.S. cotton farmers produced a record crop of 20.3 million metric tons, representing an increase of 42 percent by volume or 6 percent by acreage over the 1998 levels. By economic theory, such trends would suggest that the United States is a more efficient producer of cotton than other countries because when prices fall, only those with much lower costs would be able to expand production.

The United States is not even close to being a low-cost producer of cotton, however. A survey of the costs of producing raw cotton in 2001 by the International Cotton Advisory Committee (ICAC) shows that production costs in Benin averaged about 30 cents/lb. (and were similar for other countries in the region, such as Burkina Faso and Mali), whereas one pound of cotton produced in the United States cost almost 70 cents (ICAC 2001). Despite its relatively high cost of production, the United States was still able to expand its area under cotton cultivation and

<sup>4</sup> This discussion of the world cotton problem focuses on the period 1999–2002 (and 2001–2002 in particular), the benchmark period at issue in the Brazil–U.S. cotton dispute.

<sup>5</sup> The reasons for the collapse of cotton prices also include weak cotton demand as a result of slow world economic growth and competition from low-priced synthetic fibers.

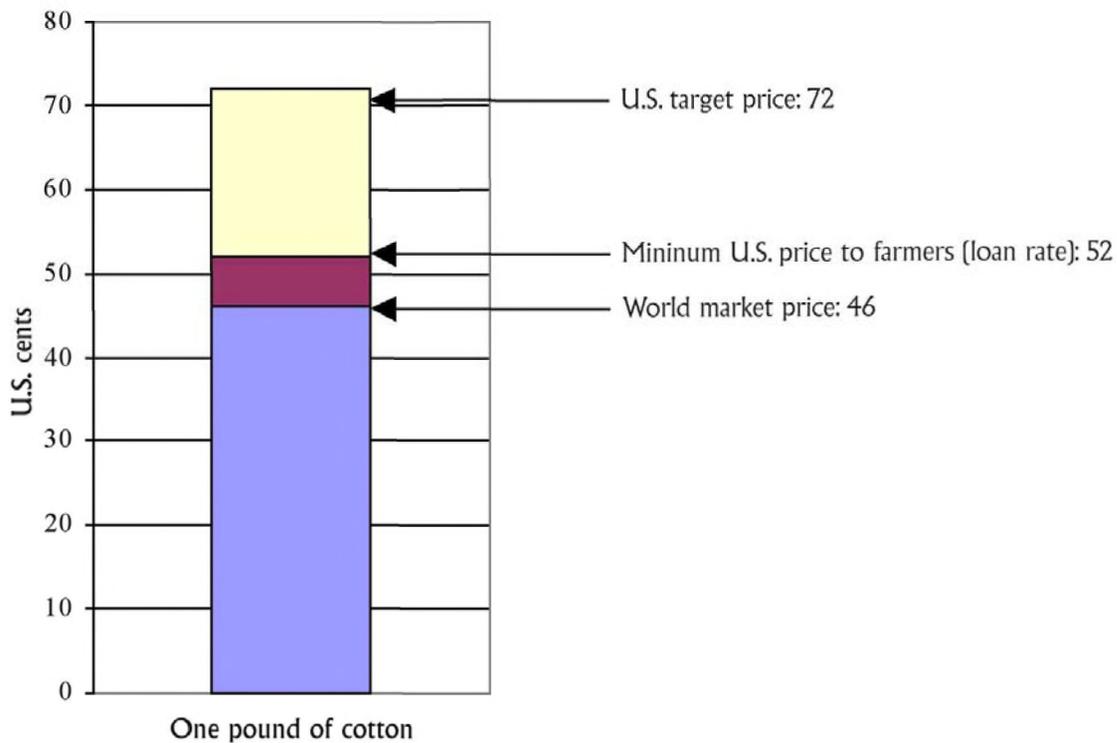
<sup>6</sup> The Cotlook A index is the average of the cheapest five quotations from a selection of the main upland cottons traded internationally. Taking the average of the five cheapest quotations is a means of identifying those growths that are the most competitive and that therefore are likely to be traded in most volume. This practice is a proxy for weighting, which is impractical, owing to the absence of timely data by which it could be calculated (Cotlook 2006).

increase its world market share, whereas several highly efficient producers in Africa and elsewhere were forced to cut production or move completely out of the market.

The competitiveness of U.S. cotton on the world market was backed up by subsidies and the United States accounts for approximately one-half of the world's total production subsidies for cotton (Watkins 2002). In 2001 the value of outlays in the form of cotton subsidies by the U.S. Department of Agriculture's Commodity Credit Corporation (CCC) exceeded US\$4 billion, higher than the value of total U.S. cotton production, which amounted to US\$3 billion at world market prices in the same

year (WTO 2002). Figure 2 breaks down the unit value of a pound of cotton produced and marketed in the United States in 2001/2002. Under the new marketing arrangements set in the 2002 Farm Act, cotton farmers were guaranteed a price of around 52 cents per pound ("loan rate"). In addition, farmers received a further set of payments (for example, "direct payments" and "counter-cyclical payments") to top up their income. The result is that, regardless of what happened to world market prices, farmers received a price of 72 cents per pound. This price was about 57 percent above the world market price in 2001/2002 (46 cents per pound).

*Figure 2: Value Composition of One Pound of U.S. Cotton*



Source: Watkins 2002.

U.S. subsidies to cotton farmers are important for the world market because a large share of the domestic production is exported.<sup>7</sup> Since 2001, U.S. exports as a share of production have averaged 59 percent, up from an average of 42 percent during the early 1990s. Today, the United States is the world's largest cotton exporter, accounting for more than 40 percent of world cotton trade in recent years. Large U.S. exports depress the world prices and impoverish farmers in developing countries who are competing against U.S. in international and domestic markets.

### Brazil–U.S. Dispute Settlement on Cotton Subsidies

In late 2002 Brazil initiated a WTO dispute settlement case (DS267) against specific provisions of the U.S. cotton program. On September 8, 2004, a WTO dispute settlement (DS) panel ruled against the United States on several key issues. On October 18, 2004, the United States appealed the case to the WTO's AB, which, on March 3, 2005, confirmed the earlier DS panel findings against U.S. cotton programs. Key findings from the panel and AB reports include the following:

1. The AB upheld the panel's finding that the "peace clause" in the WTO's Agreement on Agriculture (AA) did not apply to a number of U.S. measures, including domestic support measures for upland cotton.<sup>8</sup> In addition, Production Flexibility Contract and Direct Payment outlays are non-decoupled subsidy payments and need to be evaluated against the "peace clause" limits.
2. The AB upheld the panel's finding that the effect of the subsidy programs at issue—that is, marketing loan program payments, Step 2 payments, market loss assistance

payments, and countercyclical payments—is significant price suppression within the meaning of Article 6.3(c) of the Agreement on Subsidies and Countervailing Measures (ASCM), causing serious prejudice to Brazil's interests within the meaning of Article 5(c) of the ASCM.<sup>9</sup>

3. The AB upheld the panel's finding that Step 2 payments to domestic users of U.S. upland cotton were subsidies contingent on the use of domestic over imported goods and thus are prohibited under Articles 3.1(b) and 3.2 of the ASCM. The AB also upheld the panel's findings that Step 2 payments to exporters of U.S. upland cotton constitute subsidies contingent upon export performance within the meaning of Article 9.1(a) of the AA, and, consequently, the United States had acted inconsistently with AA Articles 3.3 and 8. In addition, the AB found that the Step 2 payments to exporters were prohibited export subsidies that were inconsistent with Articles 3.1(a) and 3.2. of the ASCM.
4. The AB upheld the panel's finding that the U.S. export credit guarantee programs at issue were "export subsidies" within the terms of the ASCM and thus circumvented the U.S. export subsidy commitments in violation of Article 10.1 of the AA and Articles 3.1(a) and 3.2 of the ASCM.
5. The panel recommended that (i) the United States should withdraw prohibited subsidies (export credit guarantees and Step 2 payments) without delay (in this case, within six months of the date of adoption of the panel/AB report or July 1, 2005, whichever was earlier); and (ii) the United States should take appropriate steps to remove the adverse effects of subsidies found to cause serious prejudice or withdraw them.

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<sup>7</sup> Although cotton subsidies are also large in China, the country has been a net importer in most years.

<sup>8</sup> The peace clause refers to Article 13 of the AA, which exempts domestic support measures from being challenged as illegal subsidies through DSM as long as the level of support for a commodity remains at or below the benchmark 1992 marketing year (MY) levels. Cotton subsidies in the United States were about US\$2.0 billion in MY1992 but rose to more than US\$4.1 billion in MY2001 and more than US\$3.1 billion in MY2002 (WT/DS267/R). The peace clause expired at the end of 2003.

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<sup>9</sup> The panel found that other U.S. domestic support programs (that is, production flexibility contract payments, direct payments, and crop insurance payments) did not cause serious prejudice to Brazil's interests because Brazil failed to prove a necessary causal link between these programs and significant price suppression.

On March 21, 2005, the WTO adopted the AB and panel reports (WT/DS267/R, WT/DS267/AB/R), initiating a sequence of events under the WTO DSM whereby the United States is required to bring its policies into line with the panel's recommendations or negotiate a mutually acceptable settlement with Brazil (see WTO 2007 for an up-to-date account of dispute settlement). In response, the U.S. government took several steps to bring the relevant programs into compliance. For example, the U.S. Department of Agriculture (USDA) modified the operation of the export credit program by issuing new regulations, basing fees that exporters must pay on the risk of non-repayment of loans made under the program. The Step 2 cotton program was terminated on August 1, 2006, after the completion of the 2005 marketing year.

## Stakeholders

### The United States

Cotton is an important agricultural commodity in the United States. During 1999–2002, U.S. cash receipts from cotton production averaged US\$4.6 billion per year, while export sales averaged more than US\$2.1 billion. Cotton is grown in various U.S. states. In 2002, 17 states reported cotton production valued at more than US\$10 million. Texas is the largest cotton-producing state, accounting for an average of 26 percent of total U.S. production since 1993 (Schnepf 2005).

Cotton is one of the principal U.S. program crops, along with wheat, rice, feed grains, soybeans, and peanuts. Qualifying U.S. cotton producers are eligible for various program benefits including direct payments, countercyclical payments, loan deficiency payments, and the recently repealed Step 2 payments. From fiscal year 1991 (FY1991) to FY2004, U.S. farm subsidies for cotton production averaged US\$1.7 billion per year, peaking in FY2000 at US\$3.8 billion (Schnepf 2005).<sup>10</sup> U.S. subsidy levels, coupled with U.S. prominence in global markets, have contributed to the sharp decrease in the world cotton price in recent years, resulting in

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<sup>10</sup> The USDA reports commodity program outlays on a fiscal year basis. The marketing year data used in the WTO case is converted from the fiscal year data. In the United States, the cotton marketing year starts August 1 and ends July 31 of the following year.

much international attention to U.S. cotton program outlays.

The WTO AB ruling on U.S. cotton subsidies has several implications for its domestic cotton policies. First, the United States must stop all “prohibited” export subsidies (that is, Step 2 payments and the subsidy element of export credit guarantees under the Export Credit Guarantee Program [GSM-102], the Intermediate Export Credit Guarantee Program [GSM-103], and the Supplier Credit Guarantee Program [SCGP]). Second, with regard to a ruling on “actionable” subsidies under the finding of serious prejudice caused by “price-contingent” subsidies (such as loan deficiency payments, marketing loss assistance payments, countercyclical payments, and Step 2 payments), the United States needs to “take appropriate steps to remove the adverse effects or withdraw the subsidy.” Third, the United States must reform or eliminate its direct payment schemes so that they are truly decoupled from production decisions.<sup>11</sup>

The ruling from the Brazil–U.S. dispute settlement also demands deep reform of current U.S. farm policies in general. Most of the panel findings could extend beyond cotton to other major field crops (depending on their subsidy rate and shares in markets), particularly those concerning the potential limits on export credit guarantees. Some trade and market analysts, as well as legislators, have expressed concern that a broad finding against provisions of the U.S. cotton program could necessitate legislative changes to bring existing program operations into compliance with WTO rules, which could in turn necessitate changes in the next farm bill (Mercier and Smith 2006).

### Cotton-Dependent Developing Countries

Cotton is widely grown in the developing world. Production and sales of cotton provides a vital source of national income and foreign exchange

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<sup>11</sup> It is noteworthy that the panel finding that U.S. direct payments do not qualify for WTO exemptions from reduction commitments as fully decoupled income support (that is, they are not green box-compliant) appears to have no further consequences within the context of this case and does not involve any compliance measures. This is because direct payments were deemed “non-price contingent” and thus were evaluated strictly in terms of the peace clause violation, not as actionable subsidies.

earnings for some of the world's poorest countries. For example, cotton accounts for approximately 40 percent of export earnings in Benin and Burkina Faso and 30 percent in Chad, Mali, and Uzbekistan. Its contribution to gross domestic product (GDP) in these and other developing countries ranges from 5 to 10 percent (Baffes 2003). Cotton also plays a pivotal role in the livelihoods of poor people. It is estimated that around 1 billion people in developing countries are directly or indirectly involved in cotton production and marketing (Watkins 2002). The state of the world's cotton economy has a critical bearing on their food security and economic well-being.

Since the mid-1990s that state has deteriorated. With continuously declining prices, many cotton farmers and traders in developing countries were driven out of the market. At a historical low price of 46 cents per pound in 2001/2002, even the most efficient producers would operate at a loss, unable to cover the costs of production and marketing. Brazil allegedly had suffered substantially from the low world price despite the fact that it is one of the lowest-cost cotton producers in the world. In its request for consultation (WT/DS267/1), Brazil showed that the U.S. subsidies induced a 41 percent increase in U.S. cotton exports, hence reducing the world price of cotton by 12.6 percent. Based on these figures, the losses incurred by Brazil were estimated at about US\$600 million for the marketing year 2001 alone (Baffes 2004).<sup>12</sup>

The impact of the price depression was even greater on the poor cotton-dependent African countries, relative to the size of their national economies. It was estimated that in 2001 Africa lost a total of US\$441 million because of trade distortions in cotton markets. Between 2003 and 2004, four West and Central African producers (Benin, Burkina Faso, Chad, and Mali) reportedly suffered a total export loss of around US\$382 million (Baden 2004). These losses are more devastating for the poor population in the least developed countries because the cotton sector usually provides the only option for access to cash income and employment. In response to the crisis, a "Sectoral Initiative in

Favor of Cotton" was raised in the WTO in 2003 by Benin, Burkina Faso, Chad, and Mali. The four countries ("cotton-4") described the damage that had been caused to them by cotton subsidies in richer countries and called for the subsidies to be eliminated and for compensation to be made to the four economies.

### Countries in the Doha Round Agricultural Negotiations

The dispute settlement on U.S. cotton subsidies has profound political implications far beyond this specific case. The cotton ruling, together with a subsequent one on sugar (against the EU), established that developed countries had failed to abide by subsidy rules that they crafted during the Uruguay Round.<sup>13</sup> This in turn has had serious damaging effects on their credibility in the Doha Round. Developing countries, on the other hand, have had an important moral and legal victory and as a result are poised in a stronger position in current multilateral negotiations.

The ruling on U.S. cotton subsidies, if fully complied with, could have substantial positive impacts on the ongoing agricultural negotiations in the current Doha Round. There could be an overall strengthening of ambition on further liberalizing agriculture trade, because developing countries and the Cairns Group could conclude that developed countries, such as the United States, are seriously interested in reform. Such a development could also increase the level of market access that developed-country producers seek to achieve in the Doha Round. In addition, U.S. compliance would increase the chances of reducing subsidies in the EU. Given that the United States wants to discipline EU subsidies, which are also subject to challenge at the DSM, implementation of the panel ruling would signal to the EU that it should do the same.<sup>14</sup> It is important to note, however, that the

<sup>12</sup> It is worth noting that during 1999–2002, Brazil's cotton production and consumption were approximately equal and only in two of the four seasons was Brazil a net cotton importer.

<sup>13</sup> In September 2002 Australia and Brazil initiated a trade dispute settlement process against the EU's sugar export subsidies (DS265 and DS266; they were later joined by Thailand [DS283]). In April 2005 the AB upheld the major findings of the panel, which ruled that the EU had subsidized sugar exports beyond the level formally notified to the WTO and was thus in violation of the WTO AA.

<sup>14</sup> The reform of the Common Agricultural Policy (CAP) and subsequent reforms in sugar, wine, fruit, and

positive effects are contingent on full U.S. compliance with the panel ruling. If it chooses not to comply, things could work in the opposite direction.

## Policy Issues

Some researchers argue that with the creation of the WTO DSM, developing countries have been more able to identify potential violations of WTO commitments and have disputes settled in their favor. Jackson (1997) and others have noted, for example, that the new dispute settlement system under the WTO is more “rule-oriented” relative to the “power-oriented” system under the GATT. Indeed, the dispute settlement in the U.S. cotton case, as well as in many others including the recent EU sugar case, appears to support such an optimistic view. Notwithstanding progress, there still exists a need to enhance the capacity of and incentives for developing countries, especially the least-developed countries (LDCs), to use the system to ensure their trading rights. More important, systemic issues relating to the implementation of panel rulings remain to be addressed in order to safeguard the interests of developing countries in a more incontestable manner.

## The Costs of Dispute Settlement

Developing countries frequently point out that the major players in the WTO DSM are usually rich and large countries such as Canada, the EU, Japan, and the United States (Table I). One reason offered in the literature is that these countries have larger trade interests relative to small and poor countries, and higher trade volumes increase the stake in liberalization, which justifies investing resources in settling a trade dispute (Horn et al. 2005). In contrast, smaller and poorer economies tend to have smaller trade stakes both overall and in individual commodities. This fact makes them more sensitive to costs in the dispute settlement process, because it may be less beneficial for them to press charges against countries that maintain illegal trade measures. From 1995 to 2002, high-income countries were involved in more than 60 percent of the dispute cases, whereas low-income countries accounted for only 7 percent.

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vegetable production in the EU have shown some progress in this direction.

In the current WTO DSM the costs of settling a case turn out to be large. There are two types of costs associated with the dispute settlement process (see, for example, Hoekman and Mavroidis 2000; Bown 2005). The first type concerns the information costs relating to the litigation. This type of cost is lower for developed countries because they are well equipped with legal talent, are well briefed by export interests, and have a worldwide network of commercial and diplomatic representation that feeds their systems with relevant data. The information costs for developing countries, in contrast, are higher since they have limited national expertise available and find it difficult to collect the type of information that is required to bring or defend a WTO case.

The second type of cost is directly related to the litigation process and consists of the lawyers’ and diplomats’ wages. It is reported that Brazil spent between US\$1 million and US\$2 million on legal fees in the cotton case against the United States (Shaffer 2005). Although both developing and developed countries may face high legal costs if they decide to litigate, developing countries may find it harder to bear this burden. For example, the costs associated with the cotton case may be prohibitive for poor African nations, because their fiscal deficits are already at dangerously high levels. In short, if the sum of the two types of costs exceeds the potential gains of legally “winning” a case, developing countries may choose not to participate in the litigation process, even though they have a right to do so and an economic interest in the dispute’s outcome.

## Retaliatory Power of the Complainants

The WTO is a set of self-enforcing agreements. From this perspective, the final outcome of a dispute settlement will depend on how effectively the winning party can force the losing one into compliance with the panel rulings. The WTO DSU stipulates that in case of noncompliance, at the end of a reasonable period of time (approximately 15 months), the plaintiff can set up specific WTO-sanctioned retaliatory measures (such as the suspension of concessions and other obligations) against the defendant to prevent continued losses, to induce change, and to deter unlawful behavior. In the WTO DSM, retaliation may play a central role as an ultimate safeguard for complainants against noncompliance, because reluctant respondents can no longer block the dispute settlement

Table 1: Participation in WTO Dispute Settlement by Members' Level of Development, 1995–2002

Income Category	No. of Cases as Complainant	No. of Cases as Defendant	Percentage of WTO Members' Total Exports
Low	20 (7%)	20 (7%)	3.8
Lower-middle	48 (17%)	35 (12%)	12.4
Upper-middle	35 (12%)	46 (16%)	10.2
High	183 (64%)	185 (65%)	73.6
Total	286 (100%)	286 (100%)	100.0

Source: Busch and Reinhardt 2003.

process and avoiding compliance is the only form of noncooperation left to them. In the cotton case, faced with the U.S. government's failure to eliminate its illegal programs by the deadline of July 1, 2005, Brazil requested authorization to take retaliatory measures during the DSB's meeting on July 15, 2005 (WT/DS267/21).<sup>15</sup>

Although the WTO DSU gives any member the possibility to use retaliation whenever noncompliance occurs, the credibility of a retaliatory threat could be different among different countries. It is evident that a retaliatory threat is more credible if the actual retaliation can lead to more welfare losses to the defendant. In this sense, larger and richer countries are more capable of imposing credible retaliatory threats against smaller and poorer countries, because rich countries usually maintain valuable market access commitments to poor countries that they can threaten to withdraw in retaliation. The more credible the threat is, the more likely a complaint will achieve full compliance from the defendant. Table 2 shows the outcome of dispute settlement by the complainant's development level. The numbers clearly show that developed countries have been more successful in gaining full concessions than less-developed ones.

Smaller countries, in contrast, are less capable of making credible threats because their potential retaliation will have little impact on the target

<sup>15</sup> Recognizing, however, that the U.S. administration had made a first step by submitting its reform proposal to Congress, Brazil signed a bilateral accord with the United States that led to suspension of the arbitration procedure in order to give the United States more time to follow through with the legislative process for eliminating the subsidies (WT/DS267/22).

market but can be costly in domestic welfare terms. It is thus not surprising that developing countries have rarely turned to retaliation to enforce dispute settlement against developed countries. The pressure for the latter to comply with panel rulings has been weak and largely moral in nature. As a result, developing countries have gained full concessions in fewer cases; about 40 percent of the cases involving poorer countries have concluded with full concessions (Table 2).

The asymmetry in enforcement power offers another reason (beyond of costs of litigation) why larger and richer countries are more likely to take up cases against smaller and poorer countries but not vice versa. With a larger economy, Brazil has more retaliatory capacity than smaller African countries to threaten to impose economic costs on the United States should it fail to comply with the panel decisions. In fact, Brazil has already announced that it plans to suspend some of its obligations under the Treaty on Trade-Related Aspects of Intellectual Property Rights (TRIPS) if the United States does not respect its obligations (WT/DS267/21).

#### Suspension of Aid or Preferential Treatment

Developing countries will always face extra-legal pressure from powerful countries, undermining the goal of objective trade dispute resolution through law. Many times, a small developing country can do little to counter EU or U.S. threats to withdraw preferential tariff benefits or foreign aid—even food aid—if the country challenges a European or U.S. trade measure. Such political tactics can undermine developing countries' faith in the efficacy of the legal system.

Table 2: Dispute Settlement Outcomes by Complainant’s Level of Development, 1995–2002

Income Category	Level of Concessions			Total
	None	Partial	Full	
Low and lower-middle	8 (29%)	8 (29%)	12 (43%)	28 (100%)
Upper-middle	4 (27%)	3 (20%)	8 (53%)	15 (100%)
High	20 (18%)	10 (9%)	82 (73%)	112 (100%)
Total	32	21	102	155

Note: Table includes disputes concluded by early 2003. Too few disputes with low-income complainants occurred during the period for them to be counted separately.

Source: Busch and Reinhardt 2003.

The literature has identified two additional types of political-economic issues that could affect countries’ willingness to participate in dispute settlement (Bown 2005). First, a complainant that receives economic assistance from a respondent would exercise self-constraint in the litigation process in order not to jeopardize its privilege. Specifically, the more reliant the complainant is on the respondent for assistance and the more aid the respondent could threaten to withdraw, the less likely that the complainant would formally participate in a case against the respondent. For example, Sub-Saharan Africa as a whole received about US\$2 billion foreign aid from the United States in 2001 (excluding food aid), which far exceeded the estimated losses they had suffered from cotton trade in that year (about US\$400 million). The U.S. foreign aid programs in the areas of economic and humanitarian assistance, such as development assistance, child survival and health funds, and HIV/AIDS initiatives, are critically important for these countries, which face profound public health, poverty, and development challenges. To avoid losing the foreign aid, none of the African countries joined the cotton dispute as co-complainants (although two participated as third parties).

The second political-economic pressure occurs when two countries participate in pre-existent preferential trade agreements or a privileged trade area. Once again, the threat of jeopardizing the economic relationship influences potential litigants’ behavior in dispute settlement.

## Policy Options

Substantial trade liberalization must be achieved if countries are to reap the benefits of globalization. Multilateral negotiations under the WTO play a pivotal role in facilitating global trade. Yet throughout the world, pressures for protectionism abound, threatening to roll back gains. Developed countries continue to succumb to lobbying by their own domestic producers and grant them protection. Simultaneously, developing countries with smaller fiscal resources respond by increasing border protection to shield their domestic farmers from declining agricultural prices. Domestic and WTO policy decisions have resulted in continued high subsidies in developed countries, matched by high tariffs in developing countries. The WTO’s DSM may offer an alternative solution to this “prisoner’s dilemma,” by regulating the behaviors of different players in the global trading system.<sup>16</sup> A globally efficient and welfare-enhancing outcome is achievable if the DSM can effectively reduce subsidies on the one hand and protection on the other. The Brazil–U.S. cotton case exemplifies the important role that the DSM plays in moving the multinational trading system in a pro-development direction. But for the vast majority of developing

<sup>16</sup> In game theory, the prisoner’s dilemma is a type of non-zero-sum game in which two players try to get rewards by cooperating with or betraying the other player. In this game setup, cooperating is a strategy strictly dominated by defecting, so that the only possible equilibrium for the game is for all players to defect. This equilibrium is not, however, Pareto optimal in the sense that both can be better off by cooperating—hence the dilemma.

countries to effectively use the system to their full advantage, some additional steps must be followed to improve the DSM.

### Lowering the Cost of Information

To lower the cost of information, a developing country government should identify an approach that can reduce the burden on individual enterprises to have expertise on WTO matters and to collect, aggregate, and analyze relevant data. One policy option toward this end is to create an independent agency that specializes in trade barrier data collection and analysis (Hoekman and Mavroidis 2000). Through periodic surveys, data could be collected from a representative cross-section of trading companies, multinationals, trade and industry associations, and consumer organizations. The information that is compiled by the agency based on the survey data would be used by policy makers to assess the status of export markets, identify restrictive policies maintained by the trading partner, and establish potential WTO dispute cases.

### Adopting Procedural Reform

Because many cases that involve developing countries pertain to relatively small trade volumes, another way of reducing the cost of litigation is to consider adopting “light” dispute settlement procedures for “small” cases brought by developing countries (Horn et al. 2005). In such cases, fewer panelists could be appointed, and the panel process could be completed in a shorter period. A shortened and simplified panel process reduces lawyer fees, which are often assessed based on the complexity and time length of a case. Another possible option is to allow “light” procedures to be used in cases where affected exports are small in absolute terms but large in relative terms for the country or countries bringing the case. For developing countries even a small absolute trade flow may represent a large proportion of its total exports. Thus, a timely resolution of the case can not only reduce litigation costs, but also minimize the damage to the export sector for the duration of the dispute settlement.

### Establishing a Permanent Panel

In the WTO DSM, panels are established by the DSB on a case-by-case basis, with panelists being current or former government officials paid by

their respective governments. An alternative to the current practice is to establish a permanent roster of panelists who would be readily available to serve in dispute settlement panels and be compensated for their time through the WTO budget (Hoekman and Mavroidis 2000). This in effect would create a standing body of jurists that is similar to the AB. Permanent panels could have a number of additional benefits, including reducing the burden on the WTO Secretariat associated with DSM, more rapid conclusion of cases, more professionalism, and greater consistency in outcomes. Such a measure would, however, increase the WTO budget and would require additional funding from the members.

### Providing Legal Aid

The creation of the Advisory Center on WTO Law (ACWL) further increases the ability of a developing country to participate in the dispute settlement process. The center, created in 2001 by a group of developed and developing countries, is designed to provide legal assistance on WTO matters to developing countries for below-market fees.<sup>17</sup> Specifically, it provides (1) general legal advice, (2) legal assistance in WTO dispute settlement proceedings, and (3) training in WTO dispute settlement. The developed members of the center have contributed the equivalent of at least US\$1 million to its endowment. Developing countries are required to make a one-time contribution that varies depending on their share of world trade and per capita income, with no contribution required from least-developed countries. From 2001 to 2005, the center provided direct assistance in about 20 WTO cases. Seven of the cases involved developing-country versus developing-country matters—in each case on behalf of the poorer complaining developing country. The other cases involved challenges to developed-country measures, with six cases directed against the EU, three against the United States, and two against Australia. The completed cases have all been at least partially successful. Although it is still too early to assess the center’s long-term impact on the position of developing countries in WTO dispute

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<sup>17</sup> For example, LDCs are charged \$25 per hour, while developing country members are charged between \$100 and \$200 per hour depending on economic size and per capita income. Developing countries that are not ACWL members may also request the Centre for legal advice, on a non-priority rate of \$250 to \$350 per hour.

settlement, the experience so far seems to be positive.

### Reconsidering Retaliation

Considering the weak enforcement power of developing countries, a recommendation frequently proposed is to change the rules so that non-implementation of panel rulings would be punished by withdrawal of market access commitments by *all* WTO members. In addition, developing countries can increase their own retaliatory power by further liberalizing their domestic market to developed-country exporters, because retaliation threats become more credible when the defendant has a larger export stake in the complainant's market. There is a basic problem, however, with unilateral or multilateral retaliation: it usually results in the complainant's responding to a WTO-inconsistent trade barrier with another trade barrier, an outcome that is contrary to the liberalization philosophy underlying the WTO. From an economic perspective, raising barriers is detrimental to the interests of the countries that do so, and to world welfare more generally. Thus, it would be much better if the WTO DSM could encourage use of the provisions in the WTO for re-negotiating concessions (Hoekman and Mavroidis 2000). This approach would ensure that the net impact of dispute resolution would be more liberal trade rather than more protectionism, as negotiation involves compensating members affected by the withdrawal of a concession by reducing other trade barriers.

### Building a North-South Alliance

Another strategy for strengthening a developing-country complainant's retaliatory power and avoiding possible political and economic repercussions is to forge alliances with constituencies within the developed countries (Shaffer 2005). By harnessing domestic political pressure and legal expertise within developed countries such as the EU and the United States, developing countries can, to a certain extent, offset the resource imbalances, enhance the credibility of their threats, and curtail the extra-legal coercion. Possible partners include the northern-based nongovernmental organizations (NGOs), consumer groups, and exporting industries that have a stake in the complainant's market.

## Assignment

Your assignment is to propose changes in the WTO DSM that would benefit small, low-income developing countries.

## Additional Readings

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