MARCO BRONCKERS and NABOTH VAN DEN BROEK

Trade retaliation is a poor way to get even

Improving the transatlantic trade and economic relationship will be high on the agenda of tomorrow's US-European Union summit in Dublin. There are many ways the two sides could go about this, but one of the most productive would be for them to change the way they remedy violations of trade agreements. Instead of resorting to trade retaliation, as they do now, the US and the EU should use financial compensation. Although governments have thus far shied away from such a mechanism, it holds real promise, not only for transatlantic trade but also for the Doha talks.

Experience with trade retaliation has been dismal. Retaliatory measures usually take the form of tariff increases. For instance, the US currently imposes a 100 per cent tariff penalty on hundreds of millions of dollars worth of European imports annually. This is supposed to put pressure on the EU to remove the import ban on US hormone-treated beef, a measure that was found in 1998 to breach World Trade Organisation rules. In return, since March this year the EU has been cranking up retaliatory tariffs by one percentage point a month, which can affect up to $4bn (€3.3bn) a year of US imports. With these tariff increases the EU wants to encourage Congress to repeal the US foreign sales corporations tax that was judged illegal in 2002.

Trade retaliation may or may not encourage compliance with the rules. But these countermeasures do a lot of harm, and often not in the right places. Innocent businesses are cut off from entire markets because of a dispute in which they are not involved. Indeed, trade retaliation flies in the face of trade liberalisation. Tariff increases on foreign products also do nothing to repair the harm done to the exporters actually affected by the illegal measure.

Further economic integration will probably mean more frequent disputes. The prospect of more frequent retaliation is a profoundly disturbing one, and not just for American-EU relations.

Most developing countries cannot realistically hope to induce compliance by restricting access to their markets. Their economies are not big enough to make a dent, and the effects of "shooting oneself in the foot" with countermeasures hurt countries with already weak economies disproportionately.

> With a system of financial compensation for breaches of trade rules, governments would be forced to confront the costs of their decisions

Ecuador made little impression on the EU when, in 2000, it threatened retaliation in response to the European bananas regime. What now if the judgment that US cotton subsidies breach WTO rules is upheld, and smaller cotton-producing countries are also given a right to take counteraction? Will the US be impressed with threats of retaliation from Ghana or Benin? Why should their exporters not receive financial compensation from the EU or the US for the damages they have incurred?

Despite these serious problems, developing countries are still being asked to take on the same WTO commitments as developed countries. That is simply not fair. Clearly, the WTO dispute settlement system needs improvement, but a sense of urgency is lacking. A deadline to revise the system by May 2004 has not been met.

The arguments in favour of a right to financial compensation are compelling. Financial compensation does not restrict trade flows, and actually helps to compensate injured industries. That is of special interest to developing countries. Financial compensation also avoids the disproportionate burden on "innocent bystanders" that retaliation always entails. Finally, the budgetary pressure of damage payments on persistent violators can create a strong financial incentive for good international citizenship.

Nevertheless, many countries – particularly developed ones – remain attached to the crude and counterproductive trade retaliation mechanism. They have come up with a variety of objections to abandoning it. Most are technical, and can be resolved. The real objection is political: with a system of financial compensation, governments would be forced to confront the costs of their decisions and international commitments would count for more. Is that such a bad idea?

It is time to introduce some common sense, and a minimum of fairness, into the resolution of international trade disputes. When governments sign up to international commitments, they must be willing to put their money where their mouths are. Financial compensation should be high on the agenda of every trade negotiator at the WTO. The EU and the US should take the lead when they meet in Dublin.

The writers practise international trade law with Wilmer Cutler Pickering Hale and Dorr LLP in Brussels

Financial Times Thursday 24 June 2004 p. 15