OXFORD

THE WORLD TRADE ORGANIZATION

LAW, PRACTICE, AND POLICY

THIRD EDITION

MITSUO MATSUSHITA,
THOMAS J. SCHOENBAUM,
PETROS C. MAVROIDIS, &
MICHAEL HAHN

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Preface to the Third Edition

Once again the authors are pleased to offer this book as a comprehensive snapshot of the law of the World Trade Organization (WTO), the centerpiece of the multilateral trading system. We are pleased to add contributions by a new co-author, Michael Hahn of the University of Bern. We have endeavoured, as with previous editions, to incorporate in the analysis, the latest case law of the WTO Panels and the Appellate Body. We believe that the law of the WTO must be understood as a synthesis of the text of the WTO treaties and interpretations of the WTO dispute settlement bodies. For this new edition, we have not only updated all the chapters but have also reorganized the book somewhat. We hope this new edition will build on the success of the first two editions in providing an understanding of international trade law, not only to specialists—economists and lawyers—but also to laypersons interested in the field.

Since the publication of the last edition, many events have occurred that affect international trade policies. The most important event, of course, was the Global Financial Crisis (GFC), which began in 2007 and is, at least in some respects, still ongoing. This crisis affected the entire world profoundly and international trade was no exception. International trade volumes plummeted as a result of the crisis and nations were less inclined to create new deals to foster increased trade. Food and natural resources shortages created a climate for export restrictions by many countries. Nevertheless, it is heartening that, thanks in large part to G-20 meetings, nations largely avoided repeating the mistakes of the 1930s, when they reacted to economic woes by constructing high import tariffs.

While the GFC enhanced the influence of the World Bank and the International Monetary Fund (IMF), the same cannot be said for the WTO. The de facto demise of the Doha Development Agenda can be attributed, partly at least, to the GFC. In fact, the future role of the WTO is now in doubt; the era of ambitious and far-reaching global trade deals and new trade rules seems to be at an end. International economic negotiations now focus on preferential trade deals that have the potential to undermine further the influence of the WTO.

Nevertheless, throughout this period of economic crisis, the WTO dispute settlement system has continued to function, creating a vast new body of case law on trade. Although far from perfect, the WTO dispute settlement system has achieved a modicum of the 'rule of law' in international economic matters, no small accomplishment. It is this 'rule of law' that we attempt to depict in this book.

We are always happy to hear from readers of this book, and we thank the editors of Oxford University Press for their encouragement and patience with respect to this work.

Mitsuo Matsushita
Thomas J. Schoenbaum
Petros Mavroidis
Michael Hahn

January 2015

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Argentina—Ceramic Tiles	Panel Report, *Argentina—Definitive Anti-Dumping Measures on Imports of Ceramic Floor Tiles from Italy*, WT/DS189/R (Sept. 28, 2001)(*adopted* Nov. 5, 2001).
Argentina—Footwear (EC)	Appellate Body Report, *Argentina—Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R (Dec. 14, 1999) (*adopted* Jan. 12, 2000).
Argentina—Footwear (EC)	Panel Report, *Argentina—Safeguard Measures on Imports of Footwear*, WT/DS121/R (June 25, 1999) (*adopted* Jan. 12, 2000, as modified by Appellate Body Report WT/DS121/AB/R).
Argentina—Hides and Leather	Panel Report, *Argentina—Measures Affecting the Export of Bovine Hides and Import of Finished Leather*, WT/DS155/R (Dec. 19, 2000) (*adopted* Feb. 16, 2001).
Argentina—Hides and Leather (Article 21.3(c))	Article 21.3(c) Arbitration Report, *Argentina—Measures Affecting the Export of Bovine Hides and Import of Finished Leather*, WT/DS155/10 (Aug. 31, 2001).
Argentina—Poultry Anti-Dumping Duties	Panel Report, *Argentina—Definitive Anti-Dumping Duties on Poultry from Brazil*, WT/DS241/R (April 22, 2003) (*adopted* May 19, 2003).
Argentina—Preserved Peaches	Panel Report, *Argentina—Definitive Safeguard Measure on Imports of Preserved Peaches*, WT/DS238/R (Feb. 14, 2003) (*adopted* April 15, 2003).
Argentina—Textiles and Apparel	Appellate Body Report, *Argentina—Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/AB/R (March 27, 1998) (*adopted* April 22, 1998).
Argentina—Textiles and Apparel	Panel Report, *Argentina—Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/R (*adopted* April 22, 1998, as modified by Appellate Body Report WT/DS56/AB/R).
Australia—Apples	Appellate Body Report, *Australia—Measures Affecting the Importation of Apples from New Zealand*, WT/DS367/AB/R (Nov. 29, 2010) (*adopted* Dec. 17, 2010).
Australia—Apples	Panel Report, *Australia—Measures Affecting the Importation of Apples from New Zealand*, WT/DS367/R (Aug. 9, 2010) (*adopted* Dec. 17, 2010, as modified by Appellate Body Report WT/DS367/AB/R).

Australia—Automotive Leather II	Panel Report, *Australia—Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R (May 25, 1999) (*adopted* June 16, 1999).
Australia—Automotive Leather II (Article 21.5—US)	Article 21.5 Panel Report, *Australia—Subsidies Provided to Producers and Exporters of Automotive*, WT/DS126/RW (Jan. 21, 2000) (*adopted* Feb. 11, 2000).
Australia—Salmon	Appellate Body Report, *Australia—Measures Affecting Importation of Salmon*, WT/DS18/AB/R (Oct. 20, 1998) (*adopted* Nov. 6, 1998).
Australia—Salmon	Panel Report, *Australia—Measures Affecting Importation of Salmon*, WT/DS18/R (June 12, 1998) (*adopted* Nov. 6, 1998, as modified by Appellate Body Report WT/DS18/AB/R).
Australia—Salmon (Article 21.3(c))	Article 21.3(c) Arbitration Report, *Australia—Measures Affecting Importation of Salmon*, WT/DS18/9 (Feb. 23, 1999).
Australia—Salmon (Article 21.5—Canada)	Article 21.5 Panel Report, *Australia—Measures Affecting Importation of Salmon*, WT/DS18/RW (Feb. 18, 2000) (*adopted* March 20, 2000).
Brazil—Aircraft	Appellate Body Report, *Brazil—Export Financing Programme for Aircraft*, WT/DS46/AB/R (Aug. 2, 1999) (*adopted* Aug. 20, 1999).
Brazil—Aircraft	Panel Report, *Brazil—Export Financing Programme for Aircraft*, WT/DS46/R (April 14, 1999) (*adopted* Aug. 20, 1999, as modified by Appellate Body Report WT/DS46/AB/R).
Brazil—Aircraft (Article 21.5—Canada)	Article 21.5 Appellate Body Report, *Brazil—Export Financing Programme for Aircraft*, WT/DS46/AB/RW (July 21, 2000) (*adopted* Aug. 4, 2000).
Brazil—Aircraft (Article 21.5—Canada)	Article 21.5 Panel Report, *Brazil—Export Financing Programme for Aircraft*, WT/DS46/RW (May 9, 2000) (*adopted* Aug. 4, 2000, as modified by Appellate Body Report WT/DS46/AB/RW).
Brazil—Aircraft (Article 21.5—Canada II)	Second Recourse to Article 21.5 Panel Report, *Brazil—Export Financing Programme for Aircraft*, WT/DS46/RW/2 (July 26, 2001) (*adopted* Aug. 23, 2001).
Brazil—Aircraft (Article 22.6—Brazil)	Recourse to Article 22.6 Arbitration Report, *Brazil—Export Financing Programme for Aircraft*, WT/DS46/ARB (Aug. 28, 2000).
Brazil—Desiccated Coconut	Appellate Body Report, *Brazil—Measures Affecting Desiccated Coconut*, WT/DS22/AB/R (Feb. 21, 1997) (*adopted* March 20, 1997).
Brazil—Desiccated Coconut	Panel Report, *Brazil—Measures Affecting Desiccated Coconut*, WT/DS22/R (Oct. 17, 1996) (*adopted* March 20, 1997, upheld by Appellate Body Report WT/DS22/AB/R).

Brazil—Retreaded Tyres	Appellate Body Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R (Dec. 3, 2007) (*adopted* Dec. 17, 2007).
Brazil—Retreaded Tyres	Panel Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, WT/DS332/R (June 12, 2007) (*adopted* Dec. 17, 2007, as modified by Appellate Body Report WT/DS332/AB/R).
Brazil—Retreaded Tyres (Article 21.3(c))	Article 21.3(c) Arbitration Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, WT/DS332/16 (Aug. 29, 2008).
Canada—Aircraft	Appellate Body Report, *Canada—Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (Aug. 2, 1999) (*adopted* Aug. 20, 1999).
Canada—Aircraft	Panel Report, *Canada—Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (April 14, 1999) (*adopted* Aug. 20, 1999, upheld by Appellate Body Report WT/DS70/AB/R).
Canada—Aircraft (Article 21.5—Brazil)	Article 21.5 Appellate Body Report, *Canada—Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/RW (July 21, 2000) (*adopted* Aug. 4, 2000).
Canada—Aircraft (Article 21.5—Brazil)	Article 21. 5 Panel Report, *Canada—Measures Affecting the Export of Civilian Aircraft*, WT/DS70/RW (May 9, 2000) (*adopted* Aug. 4, 2000, as modified by Appellate Body Report WT/DS70/AB/RW).
Canada—Aircraft Credits and Guarantees	Panel Report, *Canada—Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R (Jan. 28, 2002) (*adopted* Feb. 19, 2002).
Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)	Recourse to Article 22.6 Arbitration Report, *Canada—Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/ARB (Feb. 17, 2003).
Canada—Autos	Appellate Body Report, *Canada—Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R, WT/DS142/AB/R (May 31, 2000) (*adopted* June 19, 2000).
Canada—Autos	Panel Report, *Canada—Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R (Feb. 11, 2000) (*adopted* June 19, 2000, as modified by Appellate Body Report WT/DS139/AB/R).
Canada—Autos (Article 21.3(c))	Article 21.3(c) Arbitration Report, *Canada—Certain Measures Affecting the Automotive Industry*, WT/DS139/12 (Oct. 4, 2000).
Canada—Continued Suspension	Appellate Body Report, *Canada—Continued Suspension of Obligations in the EC—Hormones Dispute*, WT/DS321/AB/R, (Oct. 16, 2008) (*adopted* Nov. 14, 2008).

Canada—Continued Suspension	Panel Report, *Canada—Continued Suspension of Obligations in the EC—Hormones Dispute*, WT/DS321/R (March 31, 2008) (*adopted* Nov. 14, 2008, as modified by Appellate Body Report WT/DS321/AB/R).
Canada—Dairy	Appellate Body Report, *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R (Oct. 13, 1999) (*adopted* Oct. 27, 1999).
Canada—Dairy	Panel Report, *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/R (May 17, 1999) (*adopted* Oct. 27, 1999, as modified by Appellate Body Report WT/DS103/AB/R).
Canada—Dairy (Article 21.5—New Zealand and US)	Article 21.5 Appellate Body Report, *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/RW (Dec. 3, 2001) (*adopted* Dec. 18, 2001).
Canada—Dairy (Article 21.5—New Zealand and US)	Article 21.5 Panel Report, *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/RW (July 11, 2001) (*adopted* Dec. 18, 2001, as reversed by Appellate Body Report WT/DS103/AB/RW).
Canada—Dairy (Article 21.5—New Zealand and US II)	Second Recourse to Article 21.5 Appellate Body Report, *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/RW2 (July 26, 2002) (*adopted* Jan. 17, 2003).
Canada—Dairy (Article 21.5—New Zealand and US II)	Second Recourse to Article 21.5 Panel Report, *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/RW2 (*adopted* Jan. 17, 2003, as modified by Appellate Body Report WT/DS103/AB/RW2).
Canada—Feed-in Tariff Program	Appellate Body Reports, *Canada—Measures Relating to the Feed-in Tariff Program*, WT/DS426/AB/R (May 6, 2012) (*adopted* May 24, 2013).
Canada—Feed-in Tariff Program	Panel Reports, *Canada—Measures Relating to the Feed-in Tariff Program*, WT/DS426/R (Dec. 19, 2012) (*adopted* May 24, 2013, as modified by Appellate Body Reports WT/DS426/AB/R).
Canada—Patent Term	Appellate Body Report, *Canada—Term of Patent Protection*, WT/DS170/AB/R (Sept. 18, 2000) (*adopted* Oct. 12, 2000).
Canada—Patent Term	Panel Report, *Canada—Term of Patent Protection*, WT/DS170/R, (May 6, 1999) (*adopted* Oct. 12, 2000, upheld by Appellate Body Report WT/DS170/AB/R).
Canada—Patent Term (Article 21.3(c))	Article 21.3(c) Arbitration Report, *Canada—Term of Patent Protection*, WT/DS170/10 (Feb. 28, 2001).

Canada—Periodicals	Appellate Body Report, *Canada—Certain Measures Concerning Periodicals*, WT/DS31/AB/R (June 30, 1997) (*adopted* July 30, 1997).
Canada—Periodicals	Panel Report, *Canada—Certain Measures Concerning Periodicals*, WT/DS31/R (March 14, 1997) (*adopted* 30 July 1997, as modified by Appellate Body Report WT/DS31/AB/R).
Canada—Pharmaceutical Patents	Panel Report, *Canada—Patent Protection of Pharmaceutical Products*, WT/DS114/R (March 17, 2000) (*adopted* April 7, 2000).
Canada—Pharmaceutical Patents (Article 21.3(c))	Article 21.3(c) Arbitration Report, *Canada—Patent Protection of Pharmaceutical Products*, WT/DS114/13 (Aug. 18, 2000).
Canada—Renewable Energy	Appellate Body Report, *Canada—Certain Measures Affecting the Renewable Energy Generation Sector*, WT/DS412/AB/R (May 6, 2012) (*adopted* May 24, 2013).
Canada—Renewable Energy	Panel Reports, *Canada—Certain Measures Affecting the Renewable Energy Generation Sector*, WT/DS412/R (Dec. 19, 2012) (*adopted* May 24, 2013, as modified by Appellate Body Reports WT/DS412/AB/R).
Chile—Alcoholic Beverages	Appellate Body Report, *Chile—Taxes on Alcoholic Beverages*, WT/DS110/AB/R (Dec. 13, 1999) (*adopted* Jan. 12, 2000).
Chile—Alcoholic Beverages	Panel Report, *Chile—Taxes on Alcoholic Beverages*, WT/DS110/R (June 15, 1999) (*adopted* Jan. 12, 2000, as modified by Appellate Body Report WT/DS110/AB/R).
Chile—Alcoholic Beverages (Article 21.3(c))	Article 21.3(c) Arbitration Report, *Chile—Taxes on Alcoholic Beverages*, WT/DS110/14 (May 23, 2000).
Chile—Price Band System	Appellate Body Report, *Chile—Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R (Sept. 23, 2002) (*adopted* Oct. 23, 2002).
Chile—Price Band System	Panel Report, *Chile—Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/R (May 3, 2002) (*adopted* Oct. 23, 2002, as modified by Appellate Body Report WT/DS207AB/R).
Chile—Price Band System (Article 21.3(c))	Article 21.3(c) Arbitration Report, *Chile—Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/13 (March 17, 2003).
Chile—Price Band System (Article 21.5—Argentina)	Article 21.5 Appellate Body Report, *Chile—Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/RW (May 7, 2007)(*adopted* May 22, 2007).

Chile—Price Band System (Article 21.5—Argentina)	Article 21.5 Panel Report, *Chile—Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/RW (Dec. 8, 2006) (*adopted* May 22, 2007, upheld by Appellate Body Report WT/DS207/AB/RW).
China—Auto Parts	Appellate Body Reports, *China—Measures Affecting Imports of Automobile Parts*, WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R (Dec. 15, 2008) (*adopted* Jan. 12, 2009).
China—Auto Parts	Panel Reports, *China—Measures Affecting Imports of Automobile Parts*, WT/DS339/R (July 18, 2008) (*adopted* Jan. 12, 2009, upheld (WT/DS339/R) and as modified by Appellate Body Reports WT/DS339/AB/R).
China—Autos (US)	Panel Report, *China—Anti-Dumping and Countervailing Duties on Certain Automobiles from the United States*, WT/DS440/R (May 23, 2014) (*adopted* June 18, 2014).
China—Broiler Products	Panel Report, *China - Anti-Dumping and Countervailing Duty Measures on Broiler Products from the United States*, WT/DS427/R (Aug. 2, 2013) (*adopted* Sept. 15, 2013).
China—Electronic Payment Services	Panel Report, *China—Certain Measures Affecting Electronic Payment Services*, WT/DS413/R (July 16, 2012) (*adopted* Aug. 31, 2012).
China—GOES	Appellate Body Report, *China—Countervailing and Anti-Dumping Duties on Grain Oriented Flat-Rolled Electrical Steel from the United States*, WT/DS414/AB/R (Oct. 18, 2012) (*adopted* Nov. 16, 2012).
China—GOES	Panel Report, *China—Countervailing and Anti-Dumping Duties on Grain Oriented Flat-Rolled Electrical Steel from the United States*, WT/DS414/R (June 15, 2012) (*adopted* Nov. 16, 2012, upheld by Appellate Body Report WT/DS414/AB/R).
China—GOES (Article 21.3(c))	Article 21.3(c) Arbitration Report, *China—Countervailing and Anti-Dumping Duties on Grain Oriented Flat-Rolled Electrical Steel from the United States*, WT/DS414/12 (May 3, 2013).
China—Intellectual Property Rights	Panel Report, *China—Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R (Jan. 26, 2009) (*adopted* March 20, 2009).
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List of Abbreviations

ACP	African, Caribbean, and Pacific
ACWL	Advisory Centre for WTO Law
AD	Antidumping Agreement
ADP	automatic data processing
AIDCP	Agreement on the International Dolphin Conservation Program
ALOP	appropriate level of sanitary or phytosanitary protection
AMS	aggregated measurement of support
AoA (or AG)	Agreement on Agriculture (or Agriculture Agreement)
ASEAN	Association of Southeast Asian Nations
ATC	Agreement on Textiles and Clothing
BIT	bilateral investment treaty
BTA	border tax adjustment
CAP	Common Agricultural Policy
CCP	Common Commercial Policy
CCT	Common Customs Tariff
CFCs	chlorofluorocarbons
CIF	cost, insurance, freight
CITES	Convention on International Trade in Endangered Species
CLC	contingent liberalization commitment
CPC	central product classification
CRTA	Committee on Regional Trade Agreements
CTD	Committee on Trade and Development
CTE	Committee on Trade and Environment
CTS	Council for Trade in Services
CU	customs union
CVD	countervailing duty
DDA	Doha Development Agenda
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
EBA	Everything But Arms
EC	European Community
ECJ	Court of Justice of the European Union
ECT	Energy Charter Treaty
EIF	Enhanced Integrated Framework
EU	European Union
FDI	foreign direct investment
FIT	feed-in tariff
FOB	free on board
FTA	free trade agreement/area
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GFC	global financial crisis
GPA	Government Procurement Agreement

GSP	Generalized System of Preferences
HS	Harmonized System
IA	Investigating Authority
IAWG	Inter-Agency Working Group
ICJ	International Court of Justice
ICN	International Competition Network
IESO	Independent Electricity System Operator
IF	Integrated Framework
IFSC	Integrated Framework Steering Committee
IIA	international investment agreement
ILO	International Labour Organization
IMF	International Monetary Fund
INR	initial negotiation right
IP	intellectual property
IPPC	International Plant Protection Convention
IPR	intellectual property right
ITA	Ministerial Declaration on Trade in Information Technology Products
ITC	International Trade Centre
ITO	International Trade Organization
ITU	International Telecommunications Union
JITAP	Joint Integrated Technical Assistance Programme
LAN	local area networks
MAI	Multilateral Agreement on Investment
MC	marginal cost
MEA	multilateral environmental agreement
MFA	Multifibre Arrangement
MFN	most favoured nation
MMPA	Marine Mammal Protection Act
MOU	memorandum of understanding
MR	marginal revenue
NGO	non-governmental organization
NTBs	non-tariff market-access barriers
NTMs	non-tariff measures
OCDs	ordinary customs duties
ODCs	all other duties and charges of any kind
OECD	Organisation for Economic Co-operation and Development
OIE	International Office of Epizootics
OPA	Ontario Power Authority
OTDS	overall trade-distorting domestic support
PGE	permanent group of experts
PIC	prior informed consent
PCIJ	Permanent Court of International Justice
POI	period of investigation
PPMs	process and production methods
PPP	polluter pays principle
PSF	polyester staple fibres
PSI	principal supplying interest
PTA	preferential trade agreement

RPT	reasonable period of time
RTA	regional trade agreement
SAT	substantially all trade
SCM	Agreement on Subsidies and Countervailing Measures
SDR	Special Drawing Rights
SG	Agreement on Safeguards
SG&A	selling, general, and administrative (costs)
SII	Structural Impediments Initiative
SPS Agreement	Agreement on the Application of Sanitary and Phytosanitary Measures
TBT	Technical Barriers to Trade
TDC	temporary defence mechanism
TEU	Treaty on European Union
TFA	Trade Facilitation Agreement
TFEU	Treaty on the Functioning of the European Union
TOR	terms of reference
TPRB	Trade Policy Review Body
TPRM	Trade Policy Review Mechanism
TRIMs Agreement	Agreement on Trade-Related Investment Measures
TRIPs Agreement	Agreement on Trade-Related Aspects of Intellectual Property Rights
UN	United Nations
UN CPC	United Nations Central Product Classification
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNFCC	United Nations Framework Convention on Climate Change
URAA	Uruguay Round Agreements Act
VCLT	Vienna Convention on the Law of Treaties
VER	voluntary export restraint
VRA	voluntary restraint agreement
WCO	World Customs Organization
WHO	World Health Organization
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

1

The World Trade Organization

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1. Bretton Woods and the Failure of the International Trade Organization

The United States, which emerged from the Second World War as the leading political and economic power, took the lead in establishing a new post-Second World War international economic system. At the 1944 Conference in Bretton Woods, New Hampshire, the idea of founding an international organization to develop and coordinate international trade was agreed, but the main emphasis was placed on creating the International Monetary Fund (IMF) and the World Bank, so the details were left for later. After the founding of the United Nations (UN) in 1945, multilateral trade negotiations were conducted under the auspices of the UN Economic and Social Council, which in 1946 adopted a resolution in favour of forming an International Trade Organization (ITO) and convened a conference on the matter.

Negotiations over the ITO and the post-war international trading system were held in several stages: at Lake Success, New York in 1947; in Geneva in 1947; and in Havana in 1948. The Geneva meetings, which were pivotal, had three objectives: (1) draft an

ITO charter, (2) prepare schedules of tariff reductions, and (3) prepare a multilateral treaty containing general principles of trade, namely, the General Agreement on Tariffs and Trade (GATT). By the end of 1947, work had been completed on the tariff reductions and the GATT. The final work to complete a charter for the ITO was put off until 1948.

The governments of the countries engaged in the negotiations were left with a problem: how to bring the tariff cuts and the GATT into force right away without waiting on the final round of negotiations to form the ITO. The solution was to adopt a Protocol of Provisional Application to apply the GATT 'provisionally on and after January 1, 1948.'[1] In this way, the GATT and its tariff schedules could immediately enter into force, later the GATT could be revised to be consistent with the charter, and the GATT and the charter could finally be adopted.

The countries participating in the Havana Conference of 1948 completed work on the ITO charter, but the ITO charter never entered into force. Because the support of the United States was critical, other countries that were ready to adopt the ITO charter waited to see its fate in the United States. President Truman submitted the ITO charter to Congress, but the Republicans won control of Congress in the 1948 election. In 1950, the Truman administration announced that it would no longer seek congressional approval for the ITO. The ITO was dead.

2. The GATT Becomes an International Organization

The failure to adopt the ITO meant the absence of the 'third pillar'[2] on which the Bretton Woods economic structure was to be built. In fact, the GATT, which was never intended to be an international organization, gradually filled this void. The contracting parties of the GATT—the GATT could have no members—held meetings every year, and new contracting parties were gradually added. The Interim Commission for the ITO became the GATT Secretariat. The GATT evolved into an international organization based in Geneva, taking as its 'charter' the GATT, practice under the GATT, and additional understandings and agreements.

Nevertheless, the GATT always suffered from what Professor Jackson has termed 'birth defects', inherent weaknesses that handicapped its operation.[3] These birth defects included:

1. The lack of a charter granting the GATT legal personality and establishing its procedures and organizational structure;
2. The fact that the GATT had only 'provisional' application;
3. The fact that the Protocol of Provisional Application contained provisions enabling GATT contracting parties to maintain legislation that was in force on

[1] Protocol of Provisional Application to the General Agreement on Tariffs and Trade, Oct. 30 1947, 55 U.N.T.S. 308.

[2] The two 'pillars' that came into existence as agreed at the Bretton Woods Conference were the International Monetary Fund (IMF) and the World Bank.

[3] John H. Jackson, 'Designing and Implementing Effective Dispute Settlement Procedures: WTO Dispute Settlement, Appraisal and Prospects' in Anne O. Krueger, ed., *The WTO as an International Organization* (Chicago: Chicago University Press, 1998) 161, 163.

accession to the GATT and was inconsistent with the GATT (so-called grandfather rights);[4] and

4. Ambiguity and confusion about the GATT's authority, decision-making ability, and legal status.

3. A Summary of GATT Obligations

The GATT lowers tariffs by limiting tariff charges to those agreed in the Schedules of Concessions (Article II) and giving the benefit of these concessions to all GATT contracting parties (Article I). The tariff schedules are annexed to the GATT.[5] The GATT is a code of general rules regulating the conduct of the parties. Most of these rules are designed to assure that the tariff concessions work as intended and are not undermined. The GATT contains the following additional provisions:

1. A requirement of national treatment of imports with respect to taxes and regulations (Article III);
2. A prohibition on quotas, import or export licences and other measures, with some exceptions (Article XI), and a special provision relating to quotas on cinematograph films (Article IV);
3. Guarantees of freedom of transit (Article V);
4. Rules relating to subsidies and antidumping and countervailing duties (Articles VI and XVI);
5. Rules on valuation for customs purposes (Article VII);
6. Rules on fees and formalities connected with importation and exportation (Article VIII);
7. Rules on marks of origin (Article IX);
8. Rules on transparency and publication of national trade regulations (Article X);
9. Rules on currency exchange regulation (Article XV);
10. Rules on state-trading enterprises (Article XVII); and
11. Rules on government assistance to economic development (Article XVIII).

In addition, the GATT contains provisions that allow some exceptions to the basic GATT rules:

1. Exceptions for quotas for balance-of-payments purposes (Articles XII, XIII, XIV, XV, and XVII, Section B);
2. Exceptions for developing countries (Article XVIII and Part IV);
3. An exception for emergency action where serious injury is caused or threatened to a domestic industry (Article XIX) (the so-called escape clause);
4. An exception for health, safety, the protection of natural resources, and other matters (Article XX);

[4] John H. Jackson, *The Jurisprudence of GATT and the WTO: Insights on Treaty Law and Economic Relations* (Cambridge: Cambridge University Press, 2007) 84.

[5] GATT Art. XXXIV.

5. An exception for national security (Article XXI);
6. An exception for customs unions and free trade areas (Article XXIV);
7. An exception for waivers by the contracting parties (Article XXV); and
8. An exception allowing a GATT contracting party to 'opt out' of a GATT relationship on a one-time basis only, when a new contracting party joins the GATT (Article XXXV).[6]

Two GATT provisions are central to the settlement of disputes: Article XXII, which provides for consultation, and Article XXIII, which allows a GATT contracting party to make a complaint and permits the GATT contracting parties[7] to investigate and make recommendations for resolving the dispute. These provisions were the basis on which the GATT system of dispute resolution was developed and are the foundation for WTO dispute settlement procedures.

Finally, the GATT contains a number of provisions relating to procedure:

1. Procedures for modifying the Schedules of Concessions (Article XXVIII) and conducting tariff negotiations (Article XXVIII *bis*);
2. Procedures for withholding or withdrawing concessions if a state withdraws or fails to become a contracting party (Article XXVII);
3. Procedures defining which countries may be the contracting parties and for accession to the GATT (Articles XXXII and XXXIII);
4. Procedures for amending the GATT (Article XXX);
5. Procedures for withdrawing from the GATT on six months' notice (Article XXXI); and
6. Procedures for acceptance, entry into force, and registration of the GATT (Article XXVI).

The GATT also contains an Annex with notes and supplementary interpretations of various Articles. The GATT was modified in part and superseded by the GATT 1994, one of the WTO agreements. The 'original' GATT, as amended, is now known as the GATT 1947.

4. The Historical Context of the GATT

The creation of the GATT as an international organization in the 1940s may best be understood against the background of the history of international trade policy. Although the modern theoretical foundations for international trade had been laid

[6] Under the WTO Agreement, the 'opt-out' procedure is continued in modified form. The WTO agreements in Annexes 1 and 2 of the WTO Agreement do not apply between a member and any other member if either, at the time of becoming a member, does not consent. However, as between the *original* WTO members, this opt-out procedure may be exercised only where GATT Art. XXXV had been previously invoked and was still effective on 1 January 1995. See WTO Agreement Art. XIII:1 and :2.

[7] The GATT uses the terms 'contracting party' and 'CONTRACTING PARTIES' as well as the term 'contracting parties.' The latter is used when the contracting parties are 'acting jointly.' GATT Art. XXV:1. This work uses the term 'contracting parties' in place of 'CONTRACTING PARTIES.'

by economists such as Adam Smith[8] and David Ricardo[9] many years before, and trade had long been conducted by means of bilateral treaty arrangements, the GATT was an extraordinary new departure built upon two new ideas: the desirability of (1) multilateralism and (2) institutionalism. The injection of these new ideas that made possible the GATT was the result of bitter experience and the contemplation of history.

The modern era of international trade began in the nineteenth century[10] with the spread of the Industrial Revolution, which began in the United Kingdom (UK), to the nations of the European continent and to the United States. Spurred by the arguments of Smith and Ricardo, the UK gradually lowered its trade barriers to imports, culminating in the repeal of the Corn Laws in 1846. In 1860, the two major powers of the day, the UK and France, signed the Cobden–Chevalier Treaty to liberalize their trade. This development led to the conclusion of many additional bilateral trade treaties between commercial nations, and a network of non-discriminatory MFN (most favoured nation) international trade soon developed, leading to an era of rising prosperity especially in Europe. Trade continued to flourish until the outbreak of the First World War, notwithstanding economic depression in Europe (1873–96) and the growth of protectionist forces, especially on the European continent. However, political rivalries and the scramble for colonies produced departures from MFN and increasingly preferential trade treaties. Yet international trade continued with the rise of the United States, colonial trade, and the forced opening of China[11] and Japan.[12]

The First World War brought this era of flourishing international trade to an abrupt halt. Governments intervened in the form of high tariffs, quotas, and exchange controls so that intra-European trade plummeted. The war also altered the balance of power in the world as countries like the United States became creditor nations and industrial powers to fill the vacuum created by war-torn Europe.

After the war, trade policy was chaotic. Discrimination was the norm, despite US President Woodrow Wilson's call in his Fourteen Points for a general lowering of economic barriers and a revival of the MFN principle. No international plan existed for economic recovery or trade policy after the war, so each nation was on its own. Tariffs in most countries remained high, and countries instituted 'beggar thy neighbour' policies that led to monetary instability, hyperinflation, and competitive monetary adjustments. Mistrust also led to political instability. Trade policy became openly discriminatory.[13]

[8] Adam Smith's pathbreaking book, *An Inquiry into the Nature and Causes of the Wealth of Nations* was originally published in 1776 (New York: The Modern Library, 1937).

[9] Ricardo is credited with formulating the theory of comparative advantage that is foundational for international trade in his work, *On the Principles of Political Economy and Taxation* (London: John Murray, 1817).

[10] For the history of trade, see Paul Bairoch, 'European Trade Policy, 1815–1914' in P. Mathias and S. Pollard, eds., *The Cambridge Economic History of Europe*, vol. VIII (New York: Cambridge University Press, 1989) 1–160.

[11] China was compelled to sign the Treaties of Nanjing (1848) and Tianjing (1848), and the Convention of Beijing (1860), opening to trade with the West and allowing foreign states to determine its tariff levels.

[12] Japan was forced to open its ports when the 'black ships' of US Commodore Matthew C. Perry visited Yokohama in 1854. In 1857 Japan signed a Treaty of Amity and Commerce with the United States. This was followed by similar treaties with France, Holland, and Prussia in 1861.

[13] E. H. Carr, *The Twenty Years Crisis, 1919–1939* (New York: Harper and Row, 1939).

Tariff reform discussions were begun but were soon aborted by economic depression, and in 1930, the US Congress enacted the Smoot-Hawley Tariff Act, raising tariffs to unprecedented levels. This action by the strongest economic power (and the nation with the largest trade surplus) provoked widespread retaliation by other nations. By 1933 the volume of international trade had contracted by 60 per cent compared to pre-First World War levels. The United States passed the Reciprocal Trade Agreements Act of 1934 so that all countries that signed bilateral trade treaties with the United States would receive MFN treatment, but this measure came too late to reverse trends toward protectionism and favouritism among nations.[14]

At the end of the Second World War, policy makers were very conscious of this history and the lessons it taught. The benefits of open trade can elude nations in the absence of a shared commitment to international cooperation. Furthermore, international cooperation must be based on shared institutions; it cannot be left to chance. The bitter experience of the interwar years was firmly in the mind of policy makers who founded the Bretton Woods institutions and the GATT multilateral trading system after the Second World War.

5. The Need for an International Organization Concerned with Trade

This section broaches three questions that are usually taken for granted: (1) Why does international trade occur? (2) Why do we need international agreements on trade? (3) Why do we need an international organization concerned with trade?

The first question asks why international trade occurs; why self-sufficiency (what economists call 'autarky') is not a desirable goal. In the modern world we tend to look upon each state as largely autonomous; we carefully calculate GDP (gross domestic product) for each nation of the world; we tend to consider trade as somehow exceptional. But this view ignores history. In fact, what we call international trade has existed since the dawn of civilization (and probably before), pre-dating even money. Archaeologists tell us that in the fourth millennium BCE the merchants of the city-states of Sumer, in what is now Iraq, conducted an extensive international trade.[15] Trade seems to be a natural human activity that has flourished in all times and places, exceptions occurring only in times we call 'dark ages' or when forbidden by government decree.[16]

Why is trade such a universal human activity? Asking why trade occurs is different from asking whether trade is good, but the answers are relevant to both questions.

[14] For detailed analysis, see World Trade Organization, World Trade Report 2007, 'Sixty Years of the Multilateral Trading System: Achievements and Challenges' (Geneva: World Trade Organization, 2007) 40–7 (hereinafter: World Trade Report 2007).

[15] Marc Van De Mierop, *A History of the Ancient Near East* (Oxford: Blackwell Publishers, 2004) 36–7. The items traded included metals, such as copper, silver, gold, and tin; timber, tools and weapons, and ceramics. The mountains of Lebanon were known as the 'silver' mountains. Hans J. Nissen, *The Early History of the Ancient Near East* (Chicago: University of Chicago Press, 1988) 153.

[16] Most famously, the Tokugawa rulers of Japan attempted to restrict international trade by the Japanese in the seventeenth century; but much trade occurred just the same. Conrad Totman, *A History of Japan* (Oxford: Blackwell Publishing, 2000) 218–19.

Both the explanation for trade and the case for allowing trade rest on the idea that there are gains from trade. The gains from trade theorem is the proposition that if a country can trade at a price ratio more favourable than its domestic prices, it will be better off than in autarky. This gains from trade theorem is simply a reformulation of the principle of comparative advantage originally advanced by David Ricardo in 1817.[17] But the mere statement of either theorem does not tell us *why* more favourable prices may exist in some countries. Ricardo originally pointed to labour productivity as the reason: some countries can produce goods using less labour than other countries. Later economists, most notably Eli Hecksher and Bertil Olin,[18] cited different 'factor endowments'—different resources, technology levels, and any number of other items of difference—to explain the differences in price levels between nations. And factor mobility—the international movement of technology, capital, and people—complements and leads to increasing volumes of trade.[19]

The gains from trade theorem also implies that the gains involved are reciprocal in that both sides of a trade transaction benefit. This is necessarily the case as long as trade is voluntary. Of course some countries will have more comparative advantages than others; yet all will have a comparative advantage in something. Thus, the gains from trade theorem predicts that each country will naturally export those goods in which it has a comparative advantage, and the country will gain thereby through specialization.

Economists also point to gains from trade that are not linked to differences between countries in terms of factor endowments. Gains from trade may arise from economies of scale and the desire of consumers to have access to a wide variety of goods.[20] These gains explain why much trade is conducted between countries with similar technological factor endowments and why trade often flourishes within the same industries. Trade may also be beneficial by reducing or eliminating monopoly power. Trade also contributes to economic growth by improving the allocation of resources through specialization and by promoting innovation. Economists point to a strong empirical correlation between the growth of GDP and the growth of trade;[21] political scientists advance the case that trade also promotes regional and world peace.[22]

The gains from trade theorem and other explanations for trade raise some obvious questions relevant to the present work: (1) If every country gains from trade, why are international trade agreements necessary? (2) Should not trade be allowed simply to occur according to the economic realities without government involvement?

Trade agreements are necessary for the reason that governments tend to diverge from the general welfare of their citizens with respect to trade policy in two ways: (1) they have incentives to charge taxes (tariffs) on imports because these are paid (at least upfront) by foreigners; and (2) they have political (and sometimes monetary)

[17] See section 4 of this chapter.

[18] Bertil Olin, *Interregional and International Trade* (Cambridge: Harvard University Press, 1933). For the history of the development of this theory, see Eli Heckscher, 'International Trade, and Economic History' in Ronald Findley et al., eds., (Boston: MIT Press, 2007).

[19] World Trade Report 2007, 50–7.

[20] Paul Krugman is credited with these ideas. See 'Scale Economies, Product Differentiation and the Pattern of Trade', originally published in the *American Economic Review* (1980), available at <http://www.princeton.edu/pr/pictures/g-k/Krugman>.

[21] Ibid. 64. [22] Ibid. 94.

incentives to protect domestic producers in order to maximize political support and to minimize political opposition. Thus for one or other or both reasons, every country will unilaterally seek an advantage in its terms of trade, increasing national income by lowering the (aggregate) price of its imports relative to its exports. When all countries do this, the potential gains from trade are not realized. In addition, the unilateral terms of trade approach will exacerbate differences between countries, since the countries with greater power will be most successful at what is essentially a political power game.

The inefficiencies and externalities resulting from the unilateral terms of trade approach are best addressed by international trade agreements. Trade agreements reduce terms of trade externalities through reciprocity—agreements between participant countries to exchange market access on a reciprocal basis. Such market access exchanges allow all countries to an agreement to improve their welfare and to enlist domestic political support from their exporters, who are interested in reducing foreign trade barriers.[23] Multilateral trade agreements in this respect are superior to bilateral agreements in that the reduction of trade externalities is spread more widely. Since participation in international trade agreements is voluntary, the multilateral approach also ensures that all participants will gain.

It is also evident that trade agreements require trade rules and enforcement because a trade agreement alone is insufficient to eliminate the tendency of states to deviate from or to obviate market access commitments. The necessity of rules, enforcement, and the settlement of disputes on interpretation of trade rules is the justification for an international organization concerned with trade.

The desirability of trade agreements and an organization concerned with trade arises also from political theories of international cooperation. Political 'neo-realist' states will participate to seek concessions and advantages; 'neo-liberal', institutionally oriented states will participate to promote welfare and efficiency; 'constructivist' states will participate believing that international cooperation itself shapes the ideas and interest of states. The reasons may differ, but states holding very different views on international cooperation will have interests in international agreements, rules, and trade institutions.[24]

Finally, trade agreements play an essential role as legal commitments among states. Once concluded by a state and transformed into domestic law, an international trade agreement and its rules are embedded legal norms that have an impact both domestically and internationally. Domestically, trade agreement norms cannot be amended without international consequences; this gives them a quasi-constitutional status in domestic law. Internationally, trade agreements constitute a body of public international law that is part of a legal system that is separate from all national legal systems and which can be influenced, but cannot be unilaterally amended, by any one state. Since this body of law is beyond the power of any one state and is a collective creation, it is appropriate for the administration of this law to be in the hands of a collective institution, an international organization which has a collective mandate to deal with trade.

[23] Reciprocity entails that exporters can gain market access in foreign countries only if their home country tariffs are lowered.

[24] For a full analysis of the different international relations' theories on international cooperation and trade, see World Trade Report 2007, 64–79.

6. The GATT Tariff Negotiating Rounds

Despite its birth defects, the GATT served as the basis for eight 'rounds' of multilateral trade negotiations. These rounds were held periodically to reduce tariffs and other barriers to international trade and were increasingly complex and ambitious. All were ultimately successful.

A principal accomplishment of the GATT was its success in reducing tariffs and other trade barriers on a worldwide basis. The various negotiating rounds were named after the place in which the negotiations began or the person associated with initiating the round. The names and dates of the completed rounds[25] are as follows:

- Geneva 1947
- Annecy 1949
- Torquay 1950
- Geneva 1956
- Dillon 1960–61
- Kennedy 1962–67
- Tokyo 1973–79
- Uruguay 1986–94

The objective of the early GATT negotiating rounds was primarily to reduce tariffs. Non-tariff barriers later emerged as a vital concern as well. The objective of the Tokyo and Uruguay Rounds was primarily to reduce non-tariff barriers. The Uruguay Round culminated in the creation of an immense new body of international law relating to trade: the basic texts of the WTO agreements exceeded 400 pages, and the Final Act signed in Marrakesh, Morocco on 15 April 1994 was over 26,000 pages.

The Final Act of the Uruguay Round transformed the GATT into a new, fully fledged international organization called the World Trade Organization (WTO).

7. The Creation of the WTO

The idea of creating a World Trade Organization emerged slowly from various needs and suggestions. Even at the beginning of the Uruguay Round, negotiators and observers realized that significant new agreements would require better institutional mechanisms and a better system for resolving disputes. One of the fifteen negotiations undertaken at the beginning of the Round was on the 'functioning of the GATT system', dubbed with the acronym 'FOGS'. Negotiators were particularly concerned with how new agreements would come into force and whether they would be binding on all GATT contracting parties. Many countries wanted to avoid the problems of the Tokyo Round, which had resulted in significant new 'side agreements' that were binding only on those GATT contracting parties that accepted them (GATT à la carte).

Thus, Uruguay Round negotiators were receptive to the suggestion, first made by Professor Jackson, to use the Uruguay Round as an occasion to found a new 'World

[25] For details on each round, see World Trade Report 2007, 179–200.

Trade Organization'.[26] Jackson argued that it was time to cure the 'birth defects' of the GATT by creating an organization that would be a UN specialized agency with an organizational structure and a dispute settlement mechanism. The creation of such an organization could solve the problems of 'GATT à la carte'. It would be necessary to accept all the Uruguay Round agreements to be a member of the new World Trade Organization.

The idea of a new world trade organization was taken up in the FOGS negotiation. When the Draft Final Act of the Uruguay Round was issued in 1991, it contained a proposal for a new 'Multilateral Trade Organization'. Working groups and negotiators did further work, and the name was changed to the World Trade Organization. The Draft Final Act included agreements on transitional arrangements and the termination of the GATT 1947 and the Tokyo Round agreements on subjects covered by new WTO agreements. Finally, the negotiators decided that the WTO would come into being on 1 January 1995.[27] The package of agreements that brought the WTO into being was opened for signature at Marrakesh on 15 April 1994. The package consisted of multilateral trade agreements annexed to a single document, namely, the Marrakesh Agreement Establishing the World Trade Organization (WTO Agreement).[28] Through this ingenious device—the 'single undertaking' approach—all agreements annexed to the WTO Agreement became binding on all members as a single body of law.[29]

Annex 1 of the WTO Agreement is divided into three parts. Annex 1A consists of the GATT 1994 and the following agreements:

- Agreement on Agriculture
- Agreement on the Application of Sanitary and Phytosanitary Measures
- Agreement on Textiles and Clothing
- Agreement on Technical Barriers to Trade
- Agreement on Trade Related Investment Measures
- Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (Antidumping Agreement)
- Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (Customs Valuation Agreement)
- Agreement on Preshipment Inspection
- Agreement on Rules of Origin
- Agreement on Import Licensing Procedures
- Agreement on Subsidies and Countervailing Measures
- Agreement on Safeguards

[26] John H. Jackson, *Restructuring the GATT System* (London: Chatham House, 1990) 38–41.

[27] For details of the complex negotiations, see Amelia Porges, 'The Marrakesh Agreement Establishing the World Trade Organization' in T. P. Stewart, ed., *The World Trade Organization* (Chicago: American Bar Association, 1996) 63.

[28] The WTO is established formally by Art. I of the WTO Agreement. No reservations may be made to the WTO Agreement; reservations to the multilateral trade agreements are allowed only if their terms permit them. WTO Agreement Art. XVI:5. The WTO Agreement is registered in accordance with Art. 102 of the United Nations Charter. Ibid. Art. XVI:6.

[29] Ibid. Art. II:2.

Annex 1A includes a General Interpretive Note that provides that, if there is a 'conflict' between provisions of the GATT 1994 and another Annex 1A Agreement, the provision of the latter controls.[30]

Annex 1B consists of the General Agreement on Trade in Services (GATS) and its annexes. Annex 1C consists of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement).

Annex 2 consists of the Understanding on Rules and Procedures Governing Settlement of Disputes (Dispute Settlement Understanding or DSU), which establishes the procedures for resolving trade disputes among WTO members.

Annex 3 consists of the Trade Policy Review Mechanism, which establishes a periodic review of each WTO member's compliance with WTO agreements and commitments.

Annex 4 consists of the plurilateral trade agreements:

- Agreement on Trade in Civil Aircraft
- Agreement on Government Procurement
- International Dairy Agreement
- International Bovine Meat Agreement

The plurilateral agreements are binding only on the parties that have accepted them.[31] The International Dairy Agreement and the International Bovine Meat Agreement, however, were terminated in 1997.[32]

The WTO Agreement formally replaced the GATT 1947 with the GATT 1994, which is a new and legally distinct agreement. The GATT 1994 consists of the GATT 1947, excluding the Protocol of Provisional Application, as amended by all legal instruments that entered into force under the GATT before 1 January 1995, the date of the entry into force of the WTO Agreement.[33] Such legal instruments include various protocols, decisions on waivers, other decisions and understandings, and the Marrakesh Protocol to the GATT 1994. Thus, the WTO Agreement incorporates the GATT as it existed in 1994 rather than the original GATT.

8. The WTO: Functions and Structure

The WTO exists to 'facilitate the implementation, administration, and operation as well as to further the objectives' of the WTO agreements.[34] Beyond this general purpose, the WTO has four specific tasks: (1) to provide a forum for negotiations among members both as to current matters and any future agreements; (2) to administer the system of dispute settlement; (3) to administer the Trade Policy Review Mechanism; and (4) to

[30] General Interpretive Note to Annex 1A, Multilateral Agreements on Trade in Goods, of the WTO Agreement, reprinted in WTO, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (UK: Cambridge University Press, 1999) 16.

[31] WTO Agreement Art. II:3.

[32] WTO, *Deletion of the International Dairy Agreement from Annex 4 of the WTO Agreement, Decision of 10 December 1997*, WT/L/251, 17 December 1997; WTO, *Deletion of the International Bovine Meat Agreement from Annex 4 of the WTO Agreement, Decision of 10 December 1997*, WT/L/252, 16 December 1997.

[33] WTO Agreement Art. II:4 and Annex 1A.

[34] Ibid. Art. III:1.

cooperate as needed with the IMF and the World Bank, the two other Bretton Woods institutions.[35]

The WTO is formally endowed with existence, legal personality, and legal capacity as an international organization. It must be accorded privileges and immunities that are in accordance with its functions.[36]

The WTO has two governing bodies: the Ministerial Conference and the General Council. The Ministerial Conference is the supreme authority. It is composed of representatives of all WTO members and meets at least once every two years. The General Council is the chief decision-making and policy body between meetings of the Ministerial Conference.[37] The General Council also discharges the responsibilities of two important subsidiary bodies, namely, the Dispute Settlement Body (DSB) and the Trade Policy Review Body (TPRB).[38] The General Council is composed of all WTO members and meets 'as appropriate'. Thus, these three bodies, the General Council, the DSB, and the TPRB are really one administrative entity serving three different functions.

Specialized councils and committees that report to the General Council do much of the day-to-day work of the WTO. The WTO Agreement establishes these councils: a Council for Trade in Goods; a Council for Trade in Services; and a Council for Trade-Related Aspects of Intellectual Property Rights (TRIPs).[39] These Councils have the power to establish committees (or subsidiary bodies) as required.[40] The Ministerial Conference has also established committees: a Committee on Trade and Development; a Committee on Balance of Payments; a Committee on Budget, Finance and Administration;[41] and, by special action on 14 April 1994, a Committee on Trade and Environment. Additional councils and committees oversee the plurilateral trade agreements. These also report to the WTO General Council.[42]

The WTO has a Secretariat located in Geneva and presided over by a Director-General, who is appointed by the Ministerial Conference.[43] The Ministerial Conference sets the powers and term of office of the Director-General, and the Director-General has the power to appoint the staff and direct the duties of the WTO Secretariat.[44] Neither the Director-General nor the members of the Secretariat may seek or accept instructions from any national government, and both must act as international officials.[45]

The General Council has control over the WTO budget, which is prepared by the Director-General and the Committee on Budget, Finance and Administration.[46] The General Council has authority to arrange for cooperating with other inter-governmental organizations and non-governmental organizations.[47]

[35] Ibid. Art. III. [36] Ibid. Arts. I, VIII. [37] Ibid. Art. IV:1 and :2.
[38] Ibid. Art. IV:3. [39] Ibid. Art. IV:5. [40] Ibid. Art. IV:6. [41] Ibid. Art. IV:7.
[42] Ibid. Art. IV:8. [43] Ibid. Art. VI:1. [44] Ibid. Art. VI:1–3.
[45] Ibid. Art. VI:4. The Secretariat staff members 'to the extent practicable' are to be appointed from the pre-existing GATT Secretariat. Ibid. Art. XVI:2.
[46] Ibid. Art. VII. Each WTO member contributes to the budget according to its share of world trade in goods.
[47] Ibid. Art. V.

To deal with the plethora of matters that may arise concerning trade, the WTO commonly establishes ad hoc working parties and committees consisting of representatives of WTO members who participate on a voluntary, though official, basis.

8.1 Membership, accession, and withdrawal

The original WTO membership consisted of all GATT contracting parties as of the entry into force of the WTO Agreement on 1 January 1995 and the European Community (EC).[48] New members may join the WTO only after negotiating terms of accession.[49] The Ministerial Conference must approve the terms of accession by a two-thirds majority of the WTO members.[50] In practice, accession is accomplished through obtaining a consensus of all WTO members.

Accession to the WTO is a difficult and time-consuming process. In the case of China, for example, a prerequisite to the negotiation of a 'Protocol of Accession' to the WTO was the requirement of negotiating bilateral market access packages with interested WTO members. Thus, China entered into a series of bilateral trade agreements, notably with the United States[51] and the European Community.[52] Only after these bilateral negotiations were completed did substantive discussions on the text and annexes of a Protocol of Accession begin. The entire accession process, which extended over fourteen years, was finally completed when China became a WTO member by decision of the Fourth Ministerial Conference of the WTO in November 2001.

As of 2014, the WTO has 160 members. Accession agreements have been recently approved with the Russian Federation, Vanuatu, the Lao People's Democratic Republic, Montenegro, Samoa, and Yemen. At the time of writing several more states are negotiating to join.

The accession of Russia is a landmark event since this process took some eighteen years to complete and now all members of the influential G-20 are members of the WTO. With Russia as a member, the WTO can be said to be a truly universal international organization. The World Bank estimates that WTO membership will add about 3.3 per cent growth annually to Russia's GDP.[53] With Russia's accession, the United States must repeal the Jackson–Vanik Amendment,[54] which, contrary to WTO rules, requires an annual decision to grant Russia most favoured nation treatment and other trade benefits. The repeal of Jackson–Vanik further relegates Cold War trade laws to the ash heap of history.

[48] Ibid. Art. XI:1. A member also must have negotiated appropriate Schedules of Concessions. Ibid. The WTO Agreement had to be accepted formally by each original member. Ibid. Art. XIV.
Although the European Community is a WTO member, the number of votes of the European Community and its Member States may not exceed the number of votes of the Member States of the European Community. Ibid. Art. IX.

[49] Ibid. Art. XII. [50] Ibid. Art. XII:1 and :2.

[51] See Summary of U.S.–China Bilateral WTO Agreement, 2 February 2000, at <http://www.uschina.org/public/wto/ustr/generalfacts.html>.

[52] Highlights of the EU–China Agreement on WTO, at <http://www.europa.eu.int/comm/trade/bilateral/china/high.htm>.

[53] See World Bank, News, <http://www.worldbank.org/news>. [54] 19 U.S.C. § 2432 (2012).

Any member may withdraw from the WTO Agreement after giving notice to the Director-General six months before the date on which it intends to withdraw.[55]

8.2 Decision making

The WTO's decision-making processes are quite unusual. The procedures and customary practices under the old GATT are generally retained.[56] There are several types of decisions.

8.2.1 General decision making

There are two primary modes of decision making: decision by consensus and voting. For general decision making, WTO bodies continue to follow the practice of the GATT 1947 of deciding by consensus. The WTO Agreement provides that '[t]he body concerned shall be deemed to have decided by consensus if no Member, present at the meeting when the decision is taken, formally objects to the proposed decision'.[57] Thus, consensus differs from unanimity. In consensus decision making, the minority will normally go along with the majority unless it has a serious objection. The majority will, in turn, not ramrod decisions through by vote but will deal with the objections of the minority. The consensus decision-making process takes a great deal of time.

Voting may occur in the WTO only when a decision cannot be taken by consensus. In the Ministerial Conference and the General Council, decisions are taken by 'a majority of the votes cast' unless otherwise specified in the relevant WTO agreement.[58] Each member has one vote.[59] Thus, the decision-making process of the WTO is quite different from that of the IMF and the World Bank, where weighted voting favours the larger, more important states.

Despite the formal availability of voting, the WTO in actual practice adheres to the consensus decision-making procedure of the GATT. But achieving consensus has become increasingly more difficult with the increase in numbers as well as diversity of WTO members. After the failure of the Seattle Ministerial Conference in 1999, reforms were instituted after a number of developing country members denounced the consensus-building process as secretive and exclusionary.

As a result, new decision-making practices are now in place at the WTO to provide more transparency and to allow broader participation in consensus decision making. Formal decisions are still taken by consensus, but new, informal processes are now in place to prepare decisions for formal meetings. The informal consensus-building process seeks to achieve a delicate balance between efficiency, transparency, and inclusiveness.

Two procedural reforms are particularly important. In order to prepare decisions, the chairs of decision-making bodies routinely announce their intentions to hold informal discussions and ask to be notified by members who wish to be included. At regular stages of the informal discussions, the chairs also issue reports to members on

[55] WTO Agreement Art. XII:1. [56] Ibid. Art. XVI:1.
[57] Ibid. Art. IX:1. [58] Ibid. [59] Ibid.

outcomes. This consensus-building process has proved largely satisfactory to WTO members,[60] although decision making has markedly slowed and gridlock is an ever-present danger.

Informal consensus building is facilitated by the growing tendency of WTO members to form coalitions and negotiating groups with respect to various matters under discussion. These coalitions and groups associate like-minded states and group leaders emerge so that informal discussions can be more workable. The size and membership of any group is dependent on the particular issue involved; some groups in fact, such as the Cairns Group on agricultural trade, include both developing and developed members. Developing as well as developed country members tend to form multiple groups, which demonstrates that this divide, while important, is not always determinative.

8.2.2 Interpretations

The WTO has a rather strict rule concerning interpretations of the WTO agreements because WTO members realized the complexity of the huge mass of verbiage and did not want official 'glosses' to be adopted by subsidiary bodies. Thus, the WTO Agreement provides that only the Ministerial Conference and the General Council have the power to adopt interpretations of the WTO agreements by a three-quarters majority of the members. The interpretation authority may not, however, be used to undermine the amendment provisions of the WTO Agreement.[61]

8.2.3 Waivers

Safeguards have been built into the WTO waiver process in the light of difficult experiences with the waiver provision (Article XXV) of the GATT 1947.[62] Only the Ministerial Conference by three-fourths of the members can make a decision on a waiver of any obligation under the WTO agreements. A decision to grant a waiver of any obligation subject to staged implementation or a transitional period may be taken only by consensus.[63]

Waivers are subject to annual review, after which they may be extended, modified, or terminated.[64]

At the Fourth WTO Ministerial Conference in Doha, Qatar, in November 2001, waivers were accepted to settle the *Bananas* case between the United States and certain Latin American banana producers on the one hand, and the European Community on the other.[65] One waiver allows the EC to continue discriminating in favour of imports of banana producers from Africa, the Caribbean, and the Pacific;[66] a second waiver

[60] World Trade Report 2007, 327.
[61] WTO Agreement Art. IX:2.
[62] Pre-WTO waivers granted under the GATT 1947 terminated as of the date of entry into force of the WTO Agreement. Understanding in Respect of Waivers of Obligations under the General Agreement on Tariffs and Trade 1994, para. 2, reprinted in WTO, *The Legal Texts*, 29.
[63] WTO Agreement Art. IX:3.
[64] Ibid. Art. IX:4.
[65] See World Trade Organization, Ministerial Declaration of 14 November 2001, WT/MIN(01)/DEC/1, 41 I.L.M. 746 (2002) (hereinafter: Doha Declaration).
[66] Ibid. para. 1.

grants the EC the right to give tariff preferences to developing countries, including Latin American countries, on a variety of other products.[67] The EC, in return for the waiver, promised to replace its discriminatory tariff-quota regime for bananas with a tariff system by 1 January 2006.[68]

8.2.4 Amendments

Amending the WTO agreements is very difficult. To ensure there are no surprise proposals, an amendment must be formally tabled for at least ninety days before being submitted for acceptance.[69] The Ministerial Conference has exclusive competence to vote on amendments. Certain provisions of the agreements may be amended only by unanimous vote.[70] Other provisions can be amended by two-thirds vote, but such an amendment is binding only on those members accepting it.[71] The Ministerial Conference, by three-fourths vote, can decide that all members must accept an amendment, and recalcitrant members either must withdraw from the WTO or remain members with the consent of the Ministerial Conference.[72]

8.3 The WTO as an international organization

The WTO Agreement created the WTO[73] as a new international organization as of 1 January 1995, with a legal personality, legal capacity, and sufficient privileges and immunities.[74] It also endowed the WTO with decision-making processes, an institutional structure, and distinctive functions. If it maintains the support of its members and gains public understanding and support, the WTO will continue to play a key global economic role in the twenty-first century.

The WTO maintains institutional relationships with other international organizations, such as the UN, the Food and Agriculture Organization, and the International Labour Organization. More than 140 international organizations have observer status in WTO bodies.

9. Ongoing Work and Activities

The WTO is a membership organization consisting, as at the time of writing, of 152 members, which are either sovereign states or, like the European Communities and

[67] Ibid. Annex, para. 1.

[68] See 'EU Waivers Approved as Latin Americans Drop Banana Demands', *Inside U.S. Trade*, 15 November 2001, 10. In fact, the long-running dispute over bananas was not finally settled until 15 July 2008, when the European Union (EU) accepted a compromise on bananas that involves cutting import charges on Latin American bananas by 34 per cent on condition that all countries involved agree to drop further litigation. World Trade Organization, News, <http://www.wto.org, news>.

[69] WTO Agreement Art. X:1.

[70] Ibid. Art. X:2. For example, the following provisions of the WTO agreements may only be amended by unanimous vote: the amendment provision of the WTO Agreement (Art. X), GATT Arts. I and II, GATS Art. II:1, TRIPs Art. 4, and WTO Agreement Art. IX. Ibid.

[71] Ibid. Art. X:3 and :4. [72] Ibid. Art. X:5.

[73] See generally Krueger, *The WTO as an International Organization* (1998), n. 3.

[74] Ibid. Arts. I, II.

Chinese Taiwan, autonomous customs areas. Often misunderstood is the fact that all decisions are taken by the members; the WTO as an organization does not have any executive powers that it can exercise independent of the members.

The WTO Secretariat, the full-time staff of the organization, currently consists (in 2012) of 639 individuals drawn from seventy different nations. The staff, who are located only in Geneva, are almost equally composed of men and women, and their expertise is in the fields of law, economics, and international trade policy. The working languages of the WTO Secretariat are French and English.

The work of the Secretariat falls into several different categories:

- An important and time-consuming job is the organization and facilitation of ongoing trade negotiations between WTO members, most recently the Doha Development Agenda, which began in 2001. This work involves serving the needs of the Trade Negotiations Committee and its various subsidiary bodies as well as organizing the multi-faceted Work Programme of the negotiation.
- The Secretariat handles consultations and negotiations between the WTO and other multilateral organizations, such as the International Labour Organization, the World Intellectual Property Organization, and the IMF.
- The Secretariat organizes public forums and meetings with civil society groups, the media, and the general public. It is up to the Secretariat to facilitate information on the activities of the organization to these groups and to the general public.
- The Secretariat organizes and facilitates the work of the WTO dispute settlement system and acts as the staff of the Panels, the Appellate Body, and the Dispute Settlement Body.
- Training and technical assistance to developing country members constitute an important aspect of the Secretariat's work. The goal of this work is to ensure the full participation of developing countries in the work of the WTO.
- The Secretariat organizes and facilitates accession negotiations with prospective members. Currently twenty-eight nations are negotiating accession to the WTO.
- The Secretariat organizes and facilitates the periodic meetings of the standing and ad hoc committees and working groups of the WTO. The most important of these include the Ministerial Conference (usually held every two years), the General Council, and the various committees created under the many WTO agreements.
- The Secretariat organizes and carries out the Trade Policy Reviews of the members of the WTO.
- The Secretariat also prepares the Annual Report of the work of the WTO, published on the WTO website, <http://www.wto.org>.

From the foregoing analysis of the structure and activities of the WTO, four levels of decision making may be identified. First, the Director-General and the Secretariat, although in charge of day-to-day operations, have virtually no control over policy decisions; their role is limited to implementing the mandates of WTO members. Second, the bodies that administer the Dispute Settlement Understanding, the Panels, the Appellate Body, and the DSB, do not exercise policy-making power. While they exercise important responsibilities, their task is to interpret and to apply the WTO agreements and the existing *corpus* of WTO law. Third, the standing committees and

working groups of the WTO are closer to the policy-making process, but their main tasks are more mundane: monitoring and review; the identification of problems and issues; and the resolution of technical issues. Only the fourth level of decision making decides policy as such: WTO Ministerial Conferences and other meetings of WTO members at which specific trade agreements, understandings, or binding declarations are concluded.

10. Principal Accomplishments of the GATT/WTO

Unquestionably the most significant accomplishment of the GATT/WTO is the unprecedented multilateral reduction in tariffs on products in international trade. In developed countries 99 per cent of tariffs are bound, and low tariffs (averaging 3.8 per cent for industrial products) are the norm except for certain sectors, such as agriculture, textiles, and footwear. Developing countries have agreed to bind an average of 73 per cent of their tariffs, which are significantly higher than tariffs of developed countries, though these have been significantly reduced since 1980.

The lowering of tariffs on a global level has contributed to an unprecedented increase in international trade: since 1950 world trade has grown more than twenty-seven-fold in volume, three times faster than world GDP, which has expanded eight-fold during this period. The growth in world trade has created new trade relationships as more countries begin to trade with one another. Trade now occurs between countries that historically have not previously had a trade relationship.[75] It is not only lower tariffs that have made this expansion of trade possible; tariff bindings even at a relatively high level make trade more predictable and commercial relationships become more stable.

The GATT/WTO has also presided over the creation of an unprecedented expansion of the international trade rules that now cover virtually every aspect of trade. This body of law, which is separate from the domestic law of any one state, constitutes a global legal system accepted by all WTO members, who have the responsibility of transforming relevant WTO legal norms into domestic laws. The public international law of trade has expanded from its beginnings in the GATT itself to the creation of additional 'codes' dealing with aspects of trade not extensively covered by the GATT. The first such 'codes' were the product of the Tokyo Round in 1979, and more were added at the conclusion of the Uruguay Round in 1994.

The work of the GATT/WTO has not only dealt with tariffs but increasingly with non-tariff measures (NTMs) that constitute impediments to trade. The WTO agreements create international standards for all kinds of NTMs so that trade concessions negotiated between WTO members will not be undermined by NTMs. However, the regulation of NTMs means that many domestic governmental policies, such as granting subsidies, have become subject to international rules.

While the GATT covers only trade in goods, the WTO agreements concluded at the Uruguay Round extended international trade rules to three additional forms of international trade: trade in services is covered by the WTO General Agreement on Trade in

[75] World Trade Report 2007, 247.

Services (GATS); trade in technology is addressed by the WTO Agreement on Trade-Related Intellectual Property Rights (TRIPs); and foreign direct investment is addressed, although only in small part, by the WTO Agreement on Trade-Related Investment Measures (TRIMs).

A major achievement of the GATT/WTO is the elaboration of a Dispute Settlement System that allows members to negotiate and adjudicate trade disputes. Dispute settlement guarantees that members' trade commitments will be kept. From its beginnings in the GATT, the Dispute Settlement System has evolved into a structured, multilevel system with deadlines to ensure the prompt settlement of disputes. The number of cases handled since 1995 makes it certainly the busiest international tribunal in the world. The Dispute Settlement System also generates an extensive jurisprudence, adding to the *corpus* of international trade law.

The Trade Policy Review Mechanism (TPRM) may also be counted among the GATT/WTO's accomplishments. Through TPRM all members' trade policies are subject to periodic review to ensure their adherence to the obligations of the organization.

Finally, the constant demand for membership and growth of the WTO is a positive sign of its achievements and abilities. Although membership in the WTO is voluntary and itself requires significant trade concessions after often long negotiations, the organization has steadily grown to the point where it has begun to rival its sister economic organizations, the IMF and the World Bank, in the universality of its membership.

11. Major Challenges Confronting the WTO

A centrepiece for discussions concerning changes and improvements of the WTO is the 2004 Report by the Consultative Board to the Director-General Supachai Panitchpakdi, 'The Future of the WTO: Addressing Institutional Challenges in the New Millennium'.[76] This document, known as the Sutherland Report from the name of its chairman, has generated a vast literature[77] and much criticism and comment. The Sutherland Report not only contains a discussion by eight hand-picked, respected experts on the institutional problems facing the WTO, but also makes thirty-seven specific suggestions on policy and on how to improve the way that the WTO functions as an organization. In this section, we leave aside the substantive policy suggestions (dealing, for example, with matters such as erosion of the non-discrimination principle and the role of developing countries), which we will address in the appropriate substantive chapters of this book, and we limit our discussion to five significant areas: (1) improving the WTO's decision-making process; (2) enhancing the WTO's dialogue with civil society organizations; (3) achieving better coherence in global economic policy; (4) dealing with and rationalizing the proliferation of preferential

[76] Hereinafter referred to and cited as the Sutherland Report, which is available at the WTO website, <http://www.wto.org>.

[77] See, for example, Thomas Cottier et al., 'Mini-Symposium: The Future Geometry of WTO Law' (1996) *J. of Int'l Econ. L.* 9(4), 775–893; and William J. Davey et al., 'Mini-Symposium on the Consultative Board's Report on the Future of the WTO' (2005) *J. of Int'l Econ. L.* 8(3), 590–690.

trade agreements; and (5) extending the benefits (and some of the burdens) of the multilateral trading system to developing countries.

11.1 General decision making

Regarding the way that the WTO takes decisions, the Director-General, Pascal Lamy, is quoted as calling the WTO's decision-making procedures 'medieval'.[78] What Lamy was referencing was the fact that the ordinary way of taking decisions in the WTO is by consensus, a mode inherited from the days of the GATT that has become increasingly unwieldy as the membership of the WTO has grown. As the Sutherland Report stated, 'the WTO has sometimes given the impression of being unable to negotiate effectively.'[79] The consensus principle means reaching a point in negotiations where no member actively opposes a decision. In effect, consensus gives every member of the WTO veto power over every decision.

It is apparent that taking decisions by consensus has both strengths and weaknesses. On the one hand, consensus may be justified as preserving respect for national sovereignty and the legal equality of states in the international order. Decisions reached by consensus accordingly have increased legitimacy. More pragmatically, consensus may be justified on the basis that participation in the WTO is based upon exchanges of concessions, and consensus ensures the approval of such exchanges by every member. On the other hand, the consensus principle has the drawback of relegating the WTO to perpetual deadlock since it is almost impossible to achieve consensus among 160 members, with even more due to join the organization in the near future.

The Sutherland Report advocates both the retention of the consensus principle as well as several reforms designed to overcome its stultifying impact. First, the Report urges members to cause the WTO General Council to adopt (doubtlessly by consensus) a Declaration that a member may block a decision which enjoys broad support only if it declares in writing that the matter is one of vital national interest.[80] Second, the Report advocates the selective use (in tandem) of two non-consensus decision-making mechanisms: (a) greater use of the plurilateral approach to WTO obligations; and (b) increased use of the 'GATS scheduling' approach to WTO commitments.[81] In the former case, WTO members could opt out of obligations in certain agreements, resulting in a 'variable geometry' of WTO commitments, meaning that obligations would differ for different members of the organization. In the latter case, while all members would sign a given agreement, each member would have a different schedule for the nature and effective date of its commitments, making room for 'a high degree of voluntarism in concrete commitments made.' Third, the Report advocates several institutional reforms[82] to overcome the consensus-deadlock problem: (a) increased involvement of high-level national officials in meetings and negotiations (Ministerial Conferences to be held on an annual basis); (b) a greater role for the Director-General

[78] See Claus-Dieter Ehlermann and Lothar Ehring, 'Decision-making in the World Trade Organization' (2005) *J. of Int'l Econ. L.* 8(1), 51, 53.

[79] Sutherland Report, para. 270.

[80] Ibid. para. 289.

[81] Ibid. paras. 291–304.

[82] Ibid. paras. 330–2.

and the Secretariat in trade negotiations; and (c) the appointment of a 'senior officials consultative body' with limited membership and composed on a partly rotating basis that would meet periodically with the task of providing 'a political and economic context to the sometimes insular proceedings of the WTO'.[83]

Although the Sutherland Report was welcomed by many government officials, scholars, experts, and civil society organizations, the general consensus of the subsequent commentary was that the Report was too timid in its approach.[84] We also believe that the WTO Agreement is flawed in that Article IX:1 provides only two choices for general decision making: consensus and majority voting. Because majority voting is highly impractical in an organization like the WTO, consensus becomes the only option. We believe the WTO Agreement should be amended to institute new methods of taking general decisions, such as the following:

- Dividing WTO decision making into categories of decisions. For certain very important decisions, such as new agreements, consensus should be retained; for certain other decisions, such as amending existing agreements, a high-voting mechanism (such as two-thirds of the membership) might apply; and procedural decisions might be taken by a simple majority.
- The WTO should also consider adopting a weighted system of voting for general decision making, such as assigning voting power on the basis of the share of international trade (total exports and imports) of a member.
- The WTO should also establish an Executive Committee of members chaired by the Director-General whose task is to debate and to prepare proposals for consideration by the entire membership. Membership in the Executive Committee might be assigned in two ways: certain members with specified high thresholds of international trade volume would be permanent members; all other WTO members would serve on a rotating basis.

We further believe, in contrast to the Sutherland Report, that the principle of 'single undertaking' whereby all WTO members have to a great extent the same obligations should be preserved, and that a large increase in plurilateral obligations and using GATS flexibility across the board would create an uneven and terribly complex set of obligations that would not benefit the WTO or its stakeholders. Our criticism of the Sutherland Report is because the reforms it advocates do not really change the consensus approach; the plurilateral and GATS methods of decision making are simply varieties of the consensus approach albeit in a different form. And neither method has been a marked success.[85] In contrast, the reforms we advocate would allow many decisions to be taken by voting rather than consensus.

[83] Ibid. para. 324.

[84] See, for example, Joost Pauwelyn, 'The Sutherland Report: A Missed Opportunity for Genuine Debate on Trade, Globalization, and Reforming the WTO' (2005) *J. of Int'l Econ. L.* 8(2), 329–46.

[85] See the criticisms of Craig Van Grasstek and Pierre Sauvé, 'The Consistency of WTO Rules: Can the Single Undertaking Be Squared with Variable Geometry?' (2006) *J. of Int'l Econ. L.* 9(4), 837–64; and Rudolph Adlung, 'Services Negotiations in the DOHA Round: Lost in Flexibility' (2006) *J. of Int'l Econ. L.* 9(4), 865–93.

11.2 Relations with civil society

The Sutherland Report advocates several improvements designed to facilitate the WTO's relations with civil society organizations: a set of clear guidelines and objectives; greater external transparency; criteria for selecting certain civil society organizations with which the WTO might develop an enhanced working relationship; and generally more consultation with civil society organizations.[86] These suggestions build upon the substantial effort already being made by the WTO, as specified in Article V:2 of the WTO Agreement, to 'make appropriate arrangements for consultation and cooperation with non-governmental organizations concerned with matters related to those of the WTO.'

We believe relations between the WTO and civil society may be analysed on three levels: transparency; consultation; and participation in decision making. On the level of transparency, the WTO has made great strides: a great deal of information and virtually all documents may be accessed on the WTO website; registered non-governmental organizations (NGOs) may attend and receive regular briefings at WTO Ministerial Conferences and other important meetings; the oral hearings of certain WTO dispute resolution Panels and the Appellate Body[87] are open to the public; and a special NGO section has been established on the WTO website with specific information for civil society. While lacunae may still exist with regard to disclosure of the WTO's activities to civil society, we believe that the goal of transparency has largely been achieved.[88]

On the level of consultations with civil society, the WTO has opened several channels to receive communications from NGOs and members of the public. In dispute settlement proceedings, *amicus* briefs prepared and submitted by NGOs may be considered by WTO Panels and the Appellate Body; there is no 'right' that such briefs must be considered, but such briefs are now regularly submitted and acknowledged. NGOs may also submit position papers on various issues to the WTO, which will forward them on a monthly basis to members for consideration; and the WTO periodically convenes forums and symposia at which NGOs and interested parties may express their views. The WTO also organizes an annual Public Forum for civil society representatives and briefings on meetings of the WTO Council and Committees. Such Public Forums offer scores of 'workshops' on all important issues. The Director-General and members of the Secretariat regularly meet with representatives of NGOs, and WTO officials regularly attend meetings of NGOs and civil society groups.

With respect to the issue of participation in decision making, the WTO currently takes the line that, because the WTO is a membership organization founded on contractual commitments between governments, direct participation by NGOs and representatives of civil society is not appropriate, citing the common practice of most

[86] Sutherland Report, paras. 211–12.

[87] See Annex IV, Procedural Ruling of 10 July to Allow Public Observation of the Oral Hearing, United States—Continued Suspension of Obligations in the EC Hormones Dispute, AB-2008-5, WT/DS320/AB/R (2008).

[88] About twenty-five NGOs based in Geneva follow the WTO closely. NGOs, however, should realize that, because the WTO lacks executive power, lobbying the Secretariat is often a waste of time. Rather, lobbying should be directed toward members and membership groups.

inter-governmental organizations to limit direct participation to members. The Sutherland Report supports this view, stating that 'there are continuing concerns about the legitimacy, representativity, accountability, and politics of non-governmental organizations.'[89] The Report also notes that most members of the WTO oppose direct participation by non-members.[90]

The reluctance of WTO members to permit any form of direct participation by civil society groups continues to draw criticism and comment. Common charges are that the WTO lacks 'legitimacy'[91] and 'accountability'.[92] Critics often call for more democracy in decision making, citing the effects of WTO decisions on domestic institutions and on non-trade concerns, such as the environment, human rights, and employment.[93] We believe these criticisms are mistaken. Both legitimacy and accountability operate in the WTO through the negotiation positions and the decisions taken by members. The development of negotiating positions is totally up to each member, reflecting the domestic process that is unique to each particular member. If there is concern for the legitimacy of the inputs to a WTO negotiation, the blame falls squarely on the member or members, not on the WTO. Similarly, with respect to the decisions taken at the conclusion of a WTO negotiation, since each member has veto power over each facet of what the WTO decides, there is accountability on the part of each member to all domestic stakeholders. If certain domestic interests and values are not adequately considered in the WTO decision-making process, it is the fault of members, not the WTO as an inter-governmental organization.

Although civil society organizations may not directly participate in WTO decisions, they do have the opportunity to participate indirectly, in the sense of exercising influence.[94] Not only can NGOs communicate their views to the WTO itself, they can exercise influence by utilizing the domestic processes of member governments with respect both to negotiating positions and decisions taken by the WTO. As the WTO is presently constituted, virtually all policy-making decisions are taken, not by the organization itself, but by high-level meetings of WTO member governments. Since the WTO cannot take any significant decision if even one member objects, NGOs have ample opportunity to affect WTO decisions indirectly by skilful lobbying of member governments.

Democracy plays a large role in the WTO by reason of the fact that a majority of WTO members, including those which have traditionally exercised the most influence, are parliamentary democracies. The Sutherland Report discusses a proposal for the creation of a Parliamentary Assembly of the WTO composed of representatives of

[89] Sutherland Report, para. 209. [90] Ibid.

[91] Manfred Elsig, 'The World Trade Organization's Legitimacy Crisis: What Does the Beast Look Like?' (2007) *J. of World Trade Law* 41(1), 75–98; Daniel Esty, 'The World Trade Organization's Legitimacy Crisis' (2002) *World Trade Review* 1(1), 7–22.

[92] Ruth Grant and Robert Keohane, 'Accountability and Abuses of Power in World Politics' (2005) *Am. Political Science Review* 99(1), 29–43.

[93] See Elsig, 'The World Trade Organization's Legitimacy Crisis', n. 91 at 81.

[94] For example, NGOs were important in WTO decisions involving access to medicines by developing countries and in the debates on fisheries and agricultural subsidies. World Trade Report 2007, 340–1.

national parliaments of WTO members.[95] This proposal would appear simply to duplicate the representation of each member, and, while parliaments should be engaged at the domestic level with respect to negotiating positions and decisions, most WTO members oppose additional representation at a separate parliamentary level.

11.3 Achieving greater consistency in global economic policy

The Sutherland Report recommends expansion of 'horizontal coordination' activities between the WTO and other multilateral organizations having responsibility for aspects of global economic policy and governance.[96] However, the Report cautions that observer status granted to international organizations should not be automatic, but should be based upon functional complementarities. Moreover, the Report maintains that the *corpus* of WTO rules should be preserved from 'undue external influence'.[97] These recommendations, while helpful, lack specificity. One of the most common criticisms of the WTO is that its policy vision and body of rules is hermetically sealed into a self-contained regime. The need for greater coordination between the WTO and complementary international organizations implies a two-way dialogue that belies the Sutherland Report's wariness of external influences on WTO policy. We believe that the WTO should establish two-way dialogue with a wide variety of multilateral organizations not only in mainstream economic fields such as finance, exchange rates, development, and macroeconomic policy, but also in policy fields that are linked with international trade, such as workers' and human rights, the environment, and preservation of cultural diversity. Precedents for such cooperation are apparent in the work of existing WTO committees on Trade and Environment, Trade and Development, the Working Group on Trade, Debt and Finance, and the Council for Trade-Related Intellectual Property Rights. New coordination working parties or committees should be formed with respect to additional policy areas linked with international trade, such as workers' rights and cultural diversity.

11.4 Regional and preferential trade agreements

One of the most difficult challenges facing the WTO is the proliferation of regional and preferential trade agreements. Virtually every WTO member is also a party to one or more free trade agreements or some other variety of preferential trade agreement. As of 2007, 189 free trade agreements were in force, 124 notified under the GATT Article XXIV, twenty-one under the WTO Enabling Clause authorizing preferential agreements between developing countries, and forty-four notified under GATS Article V. At the time of writing, some 474 bilateral, regional, and cross-regional preferential trade agreements have been notified to the WTO,[98] which means the number of such agreements more than doubled from 2007 to 2013.

[95] Sutherland Report, paras. 201–5. [96] Ibid. para. 175. [97] Ibid. para. 166.
[98] World Trade Organization, 'Preferential Trade Agreements', <http://ptadb.wto.org>.

The number of free trade and other preferential agreements was relatively low until the 1980s. But since that time, the pace of concluding such agreements has accelerated with no end in sight. There is concern among both academics and policy makers that the sheer number and economic power of such arrangements may overwhelm the multilateral trading system of the WTO.[99] The wave of concluding preferential trade agreements continues unabated; major economies are negotiating ever far-reaching agreements: in 2013, the United States, Japan, and ten additional nations began negotiating an agreement to form a Trans-Pacific Partnership for trade; the European Union (EU) and Japan are negotiating a free trade agreement; and Japan, China, South Korea, and ten Association of Southeast Asian Nations (ASEAN) are negotiating a far-reaching 'ASEAN plus 3' free trade agreement. In 2012, the United States and the EU began a negotiation to establish a Transatlantic Trade and Investment Partnership free trade area.

Controversy exists as to whether regional trade agreements are 'building blocks' for further trade liberalization, on the one hand, or 'stumbling blocks' to stronger multilateral trade on the other.[100] Given the number and variety of preferential arrangements, undoubtedly cases can be made for both points of view. In 1996 the WTO created a Committee on Regional Trade Agreements (CRTA) charged with the task of evaluating existing regional agreements and assessing their compatibility with WTO rules. The CRTA, however, has made little progress, and the matter was relegated to the Doha Development Agenda, which has likewise not come to any conclusions.

The issue of regionalism and preferential trade agreements is dealt with by GATT Article XXIV and GATS Article V. However, the standards set out in those Articles are vague and ill-defined. There is also concern as to whether existing standards are adequate to protect the multilateral trading system from erosion.

Since so many preferential trade agreements exist, and because of their political as well as economic importance, it is unlikely that the WTO can adopt stricter rules on their characteristics. The best way forward would appear to be for the WTO (1) to produce agreed statements of interpretation of the existing rules; (2) to provide a negotiating forum for the harmonization and coordination of existing regional agreements, especially with respect to rules of origin; and (3) to provide economic and legal advisory services as needed for the conclusion or amendment of such agreements.

11.5 Developing countries and trade

For more than a half-century, first the GATT and now the WTO have struggled with the matter of how to better integrate developing countries into the multilateral trading system. With the expansion of WTO membership, developing countries now constitute the overwhelming majority of WTO members. Since the end of the Uruguay Round, developing countries have increasingly dominated the WTO's agenda.

The WTO must meet the challenge posed by the needs of developing country members. This means that the WTO must accept and act on the reasonable demands

[99] James H. Mathis, *Regional Trade Agreements in the GATT/WTO* (The Hague: T.M.C. Asser Press, 2002) 229–34.

[100] World Trade Report 2007, 312–16.

of developing countries. The WTO has mounted the Aid for Trade[101] initiative to help developing countries meet the costs of implementing WTO-required trade measures as well as enabling them to participate more meaningfully in the deliberations of the WTO. The successful conclusion of the Doha Development Agenda is needed to convince developing countries that the WTO is capable of acting in their interests as well as in the interests of developed members. It will be a long-term process, however, to accommodate the many diverse needs of developing countries. This will be a major future challenge for the WTO.

12. The Doha Development Agenda

On the occasion of the Fourth Ministerial Conference in November 2001 in Doha, Qatar, a mandate for trade negotiations on a broad range of subjects was agreed, known as the Doha Development Agenda (DDA). This negotiation, which is the ninth trade negotiating round since the inception of the GATT/WTO, has endured (at the time of writing) for over eight years. The topics discussed in the DDA are very comprehensive in the manner of previous rounds; they include: agriculture, market access for non-agricultural products, services, intellectual property, trade and development, trade and environment, trade facilitation, WTO rules revisions, and dispute settlement.[102] The DDA is distinctive in the history of the WTO in that developmental concerns and benefiting WTO developing country members are paramount.

Despite repeated statements by WTO members that successful conclusion of the DDA is important,[103] the repeated slippage of key deadlines and shifting power balances within the WTO membership indicate that completion of the DDA is not a high priority. Many members have instead turned to concluding bilateral and regional trade agreements,[104] an indication that key countries have given up on the DDA.

On 31 May 2011, Pascal Lamy, then Director-General of the WTO, formally pronounced before the WTO Trade Negotiating Committee that the DDA as we know it is 'dead'.[105] We concur with Mr Lamy's opinion. Although the parties to the WTO have not formally announced a repudiation of the goals of the DDA, the political will to achieve an agreement simply is not present.

Regardless of the ultimate fate of the DDA, we believe that the era of broad 'rounds' of global trade negotiations has come to an end, and that in the future WTO trade negotiations will be concerned with narrowly focused issues relating to existing trade

[101] Aid for Trade refers to the effort mounted by the WTO to build infrastructure and to promote the productive capacity of developing countries so that their development may be fostered through expanded trade. See World Trade Organization, Ministerial Declaration of 18 December 2005, WT/MIN(05/W/3/Rev.2, para. 57, available at <http://www.wto.org>. For details on this initiative, see OECD, *The Development Dimension, Aid for Trade, Making it Effective* (Paris: OECD Publishing, 2006).

[102] For details on these topics, see World Trade Organization Annual Report 2009, 15–28.

[103] See World Trade Organization, Chairman's Summary of the Seventh WTO Ministerial Conference issued on 2 December 2009 (available at <http://www.wto.org/news>).

[104] In 2008 alone, 35 new regional trade agreements were notified to the WTO, the largest number ever concluded in a single year.

[105] World Trade Organization, Chairman's opening remarks, Trade Negotiating Committee: 2011 News Items (31 May 2011), available at <http://www.wto.org/english/news_e/news11/e.htm>.

agreements. Thus, the WTO may be entering a new era in its history and may have to reexamine its core functions to remain vital as an international organization.

13. The 'Bali Package'

At the Ninth WTO Ministerial Conference held in Bali, Indonesia, in December 2013, WTO parties produced what is known as the 'Bali Package',[106] a set of agreements and decisions that we think represents the future of what the WTO can achieve in the area of trade negotiations. The centrepiece of the 'Bali Package' was an Agreement on Trade Facilitation to simplify customs procedures by reducing costs of compliance and improving their speed and efficiency. The 'Bali Package' also included decisions on issues stemming from existing WTO agreements: (1) an extension of the agreement not to charge import fees on electronic commerce; (2) an agreement not to file non-violation complaints involving intellectual property; and (3) an agreement on the administration of tariff-quotas in agricultural products. A third and very important aspect of the 'Bali Package' involved agreements and decisions on development issues: (1) a reaffirmation of the importance of Aid for Trade; (2) an agreement to give special consideration to trade issues involving small economies; (3) an agreement to resolve issues inhibiting transfer of technology; (4) duty-free access and simplified preferential rules of origin to benefit least developing countries; and (5) decisions to protect food security in developing countries.

14. The Future of the WTO

If the WTO can no longer function as a forum for broad global trade negotiations as it has for over a half-century, what is the future of this organization? What role will it play? We believe that the WTO will continue to play a vital role in international trade but that that role will be substantially different than before. The WTO in the twenty-first century will function more to administer and to monitor existing trade agreements and rules rather than to serve as a forum to achieve giant new trade pacts. The WTO will also continue to play a vital role as the most important forum for trade dispute settlement. Beyond these two very important roles we believe the WTO, as the preeminent global organization with a mandate to deal with international trade rules, will play an important role in four key areas.

First, the WTO is uniquely positioned to resolve issues stemming from the existing *corpus* of WTO agreements and jurisprudence. The 'Bali Package' is very much a model for what will be achieved by the WTO in the future. In the future, issues and problems will arise out of the existing rules of international trade law. The WTO committees and the Ministerial Conference will play an indispensable role in resolving these issues and problems.

Second, the WTO will be called on to address important development issues and problems related to trade. Now that the WTO is overwhelmingly composed of

[106] For the text of the agreements and decisions, see World Trade Organization, Ministerial Decision of 7 December 2013, WTO Doc. WT/MIN(13)/36-WT/L.911, available at <http://www.wto.org>.

developing country members, including thirty-four least developing countries, the focus on development is necessary and appropriate.

Third, the WTO will sponsor important plurilateral agreements related to trade. An example of this is the current negotiations among some fourteen WTO members including the EU to achieve a new agreement concerning trade in green technologies. This negotiation aims to achieve global free trade in environmental goods and services. Any agreement reached will be open to all WTO members to join, although some will not do so. Thus, a plurilateral agreement in this sector can achieve a great deal although some of the now 160 WTO members will not agree.

Fourth, we believe the WTO can play an important role in dealing with areas of trade and international economic governance, such as harmonization and coordination of the plethora of preferential trade agreements and international competition issues involving international trade through refinement of the role of the Trade Policy Review Mechanism.[107] We see an important new role for the WTO in expansion of TPRM that was included as Annex 3 of the Marrakesh Agreement creating the WTO. The original purpose of TPRM was surveillance of the trade policies of members to ensure their conformity with WTO rules. This purpose has largely been achieved. The WTO rules in conjunction with TPRM and the dispute settlement system have successfully established the rule of law in the global trading system. However, we see a future role for TPRM that would serve to enhance not only the rule of law but also political cooperation between WTO members.

The global financial crisis that began in 2007 motivated a new use for TPRM. At the request of the G-20 nations, the Director-General of the WTO, in cooperation with the Organisation for Economic Co-operation and Development (OECD) and the United Nations Conference on Trade and Development (UNCTAD), used TPRM to undertake a survey of all WTO members to determine the extent to which trade-restricting measures were being employed in response to the global financial crisis. The result was a Joint Report issued on 14 September 2009, which detailed over 100 trade-restricting and other protectionist measures adopted by WTO members during 2008–09.[108] The Joint Report called attention to the political commitments made at the G-20 meetings in November 2008 and April 2009 pledging to maintain open trade and investment policies during the crisis, and called on WTO member governments to 'start planning a coordinated exit strategy that will eliminate these [trade-restrictive measures] as soon as possible.' Although the Joint Report was legally non-binding, its impact was important both because of full disclosure of the measures involved and because many governments came under diplomatic pressure to fulfil the pledges made at the G-20 meetings. For the first time TPRM was employed as a 'soft law' political tool to guide WTO members to make correct and coordinated policy choices to enhance international trade.

[107] See Julien Chaise and Mitsuo Matsushita, 'Maintaining the WTO's Supremacy in the International Trade Order: A Proposal to Refine and Revise the Role of the Trade Policy Review Mechanism' (2013) *J. Int'l Econ. L.* 16, 1.

[108] The full Joint Report is available at <http://www.wto.org/english/news>.

We believe that this 'soft law' use of TPRM may be the harbinger of an important new role for the WTO. TPRM may be usefully employed in many additional areas to supplement the 'hard law' of the WTO agreements so that they operate more smoothly. We believe that there should be a new emphasis on 'soft law' solutions at the WTO now that making new 'hard law' agreements seems to have run its course. 'Soft law' can usefully be employed to smooth the hard edges of certain WTO agreements and to solve problems that are resistant to 'hard law' solutions. Some examples of areas where TPRM may be employed include (1) the harmonization and coordination of regional preference agreements and (2) trade and environment issues. With respect to the former subject, there is wide agreement that GATT Article XXIV is an imperfect solution to harmonizing free trade agreements with the rules of the global trading system, but 'hard law' reform has proved impossible. We believe TPRM might be used on a periodic basis to encourage harmonization of rules of origin and other problematic issues surrounding the now widespread use of such agreements.

With respect to trade and environment, we believe that TPRM could also play a useful role where agreement on 'hard law' rules is impossible. For example, border tax adjustment is a topic on which there may be many disparate opinions when it comes to energy inputs into imported or exported products where the energy inputs disappear in the course of production. A 'soft law' solution to this problem might accordingly be more acceptable and feasible than hard law rules.

In summary, the WTO will remain a vital and important—and indispensable—international organization even though the curtain may have come down on broad global trading 'rounds' negotiations such as occurred in the twentieth century. The future work of the WTO will still include serving as a forum for negotiations over particular issues related to the existing agreements, but we believe that the '*corpus*' of hard WTO law has largely been achieved, and that new 'hard law' agreements will be few and far between. Thus the work of the WTO will shift towards more 'soft law' harmonization and TPRM will have enhanced importance. In addition, the WTO will continue its important work in the areas of implementation and monitoring compliance with existing WTO agreements; dispute settlement; building the trade capacity of developing country members; and outreach activities with non-governmental organizations, parliamentarians, and other international organizations.

2

WTO Law and Domestic Law

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1. Introduction

The relationship between WTO law and domestic law is a two-way relationship. The WTO legal order is shaped by what its members have developed as their trade laws over the years. For example, today's WTO antidumping (AD) disciplines are what they are due to the experience of WTO members with this instrument over more than 100 years.[1] In the Uruguay Round, members negotiated—on the basis of their pertinent experiences with their own and foreign laws—new international standards, to which they promised allegiance:

> Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements.[2]

As members undertook to abide by their WTO obligations, all state organs have to ensure that their respective actions do not entail the international responsibility of their state. WTO organs will be exposed to domestic law first in the context of reviews of domestic law in the Council[3] and in a multitude of specialized sub-structures of the Council, such as, for example, the Committee on Technical Barriers to Trade (TBT Committee) established pursuant to Article 13 of the Agreement on Technical Barriers to Trade.[4] Most importantly, though, it is the regular task of both Panels and the

[1] The first proper antidumping legislation was the Canadian Act to Amend the Customs Tariff 1897, 4 Edw VIII, 1 Canada Statutes 111 (1904).

[2] WTO Agreement, Art. XVI:4.

[3] For example, in the context of the Trade Policy Review Mechanism pursuant to Annex 3 of the WTO Agreement.

[4] WTO Doc G/TBT/1/Rev.10 Page 20: '*(ii) Timing of Notifications* . . . In 1995, the Committee agreed that when implementing the provisions of Articles 2.9.2, 3.2 (in relation to Article 2.9.2), 5.6.2 and 7.2 (in relation to Article 5.6.2), a notification should be made when a draft with the complete text of a proposed technical regulation or procedures for assessment of conformity is available and when amendments can still be introduced and taken into account.' An example are the notifications by Australia and New Zealand of their proposals to introduce plain packaging of tobacco products; see, e.g., WTO Doc. G/TBT/N/NZL/62 (24 July 2012).

Appellate Body to examine whether the rights of the complaining member have really been affected by another member's laws and regulations, as alleged by the complaints. Drawing on the decision by the Permanent Court of International Justice (PCIJ) in *Certain German Interests in Polish Upper Silesia*,[5] the Appellate Body has recognized that the domestic law of WTO members, for the purposes of Appellate Body procedures, may serve as evidence of facts and of state practice. The state of play is well summarized in the two following excerpts from two Appellate Body reports:

> The . . . municipal law of WTO Members may serve not only as evidence of facts, but also as evidence of compliance or non-compliance with international obligations. When a panel examines the municipal law of a WTO Member for purposes of determining whether the Member has complied with its WTO obligations, that determination is a legal characterization . . . [6]
>
> [A] panel's assessment of the meaning and content of a Member's municipal law is subject to appellate review in order to determine whether the panel erred in its finding regarding the consistency of the Member's municipal law with the WTO agreements. For example, in *China – Auto Parts*, the Appellate Body examined one provision of a Chinese Decree, focusing on the text and context of the relevant provision in the Decree and the overall "structure and logic" of the Decree, so as to determine whether the legal characterization by the panel was in error. At the same time, Article 17.6 of the DSU places some constraints on the Appellate Body's review of some elements of a panel's analysis of municipal law. Where, for instance, a panel resorts to evidence of how a municipal law has been applied, the opinions of experts, administrative practices, or pronouncements of domestic courts, the panel's findings on such elements are more likely to be factual in nature, and the Appellate Body will not lightly interfere with such findings.[7]

The question of how the WTO adjudicative organs deal with domestic law will be examined in greater detail in Chapter 4. This chapter rather focuses on how the domestic legal orders of three WTO members—with which the authors are familiar—position themselves vis-à-vis WTO law. As will be seen, the results are surprisingly similar, despite the significant differences that exist in these jurisdictions with regard to the relationship between treaty law and domestic law.

Before we address, in most general terms, how the European Union (EU), Japan, and the United States implement WTO law in their domestic legal order, some general remarks from the perspective of public international law may be helpful:

- First, pursuant to Article II:2, the WTO Agreement with its annexes is 'binding on all Members'. As indicated earlier, Article XVI:4 of the WTO Agreement mandates that members shall ensure the conformity of their laws, regulations, and administrative procedures with the substantive obligations contained in the Annexes of the

[5] *Certain German Interests in Polish Upper Silesia, Germany v Poland*, Merits, Judgement, (1926) PCIJ Series A no 7, ICGJ 241 (PCIJ 1926), 25 May 1926.

[6] *China—Auto Parts* (Appellate Body), para. 225; see also *India—Patents (US)* (Appellate Body), para. 65.

[7] *China—Publications and Audiovisual Products* (Appellate Body), paras. 177–8.

WTO Agreement. That includes the obligation to eventually change, if necessary, domestic legislation that has been held by the Dispute Settlement Body (DSB) not to be in conformity with the member's WTO obligations.

- Second, if a state falls short of this obligation, it acts—in diplomatic WTO parlance—in a WTO-incompatible manner. The more robust language of the law of state responsibility would call such non-performance of a treaty obligation an internationally wrongful act.[8] That the full performance may be legally impossible, for example due to a decision of the jurisdiction highest court, is technically irrelevant.[9]
- Third, it is up to each member of the WTO to determine, within the above parameters, how to implement the obligations undertaken in the WTO Agreement (and its annexes). Thus, WTO law may or may not be given direct effect or may or may not enjoy primacy *within the domestic legal order*.[10]

We now consider how the EU, Japan, and the United States implement their WTO obligations into their domestic legal orders. These three legal orders happen to be the home jurisdictions of the authors and serve as examples of how the obligation to observe WTO norms may be carried out.

2. The European Union

The EU is a regional international organization established by now 28 Member States through two treaties, the Treaty on European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU).[11] It distinguishes itself from other international organizations in that Member States have attributed it with competences that may either a priori render pertinent state activity incompatible with EU law ('exclusive competences', TFEU Article 3) or may, through the use of such legal title, pre-empt the states from continuing to act or legislate ('shared competences', TFEU Article 4). The latter may lead to an exclusive EU *external* competence even in the area of shared *internal* competences, pursuant to TFEU Article 3(2). Union law enjoys primacy over the laws of Member States[12] and may have direct effect.[13] Member State

[8] Art. 2 of the International Law Commission (ILC) Draft articles on Responsibility of States for Internationally Wrongful Acts (Elements of an internationally wrongful act of a State): 'There is an internationally wrongful act of a State when conduct consisting of an action or omission: (*a*) is attributable to the State under international law; and (*b*) constitutes a breach of an international obligation of the State.' That this may also be a treaty-based obligation follows from Art. 12 (Existence of a breach of an international obligation): 'There is a breach of an international obligation by a State when an act of that State is not in conformity with what is required of it by that obligation, regardless of its origin or character.'

[9] Art. 27 (first sentence) VCLT (Internal law of States, rules of international organizations and observance of treaties): 'A State party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform the treaty.'

[10] As a matter of international law, international treaty obligations, of course, trump conflicting domestic laws, as Art. 27 of the Vienna Convention on the Law of Treaties (VCLT) shows.

[11] Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union can be found in the EU's official gazette, the *Official Journal* C 83, 30.3.2010. For an excellent overview of the EU's legal order cf. Paul Craig and Gráinne de Búrca, *EU Law: Text, Cases and Materials*, 5th edn. (Oxford: Oxford University Press, 2011).

[12] Case 6/64 *Flaminio Costa v E.N.E.L.* [1964] ECR 585.

[13] Case 26/62 *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1.

courts will not apply their domestic law to the extent that it is incompatible with directly applicable EU law.[14] Because of these unique features, the EU and its governance is sometimes described as quasi-federal.

The Union legislators are, on a co-equal footing, the directly elected European Parliament and the Council of the European Union; the latter is composed of the representatives of the governments of Member States. Hence, the Union only uses its competences to the extent that its Member States deem this appropriate and politically advantageous.[15]

Both the EU and its Member States are members of the WTO (cf. Arts. IX:1, XII:2 WTO Agreement); in fact, the Union and most of its Member States are original (founding) members of the WTO. This consolidates prior practice: All Members of what was then the European (Economic) Community[16] had been contracting parties of the General Agreement on Tariffs and Trade (GATT), whereas the Community, established ten years after the GATT entered into force, never formally joined the ranks of the GATT contracting parties. However, the Union (and its predecessor) have, since 1957, been attributed with the competence for the external economic relations of the EU (common commercial policy (CCP)). In fact, this competence, now enshrined in TFEU Articles 206 and 207, was for a long time the only significant EU foreign relations power and remains in many ways the most important one.

Both within the Union and in GATT practice, the *exclusive* competence of the Union became undisputed from the mid-1960s[17] and the EU was treated as a de facto contracting party of the GATT, both with regard to negotiations[18] and to dispute settlement.[19] This was due not least to a line of decisions by the Court of Justice of the European Union (ECJ) that interpreted the CCP as an interface to international economic law: the Union's competence had to be interpreted, on that view, in a dynamic way that allowed optimal representation of the newly created subject of international law that was the EU.[20] The Union's executive organ, the EU Commission, represented the Union (and for possible residual competences) the Member States in all GATT disputes and in all multilateral rounds of trade negotiations, including the Uruguay Round, where it exercised, together with other leading trading nations, significant leadership and influence.[21]

[14] cf. Case 106/77 *Amministrazione delle Finanze dello Stato v Simmenthal SpA* [1978] ECR 629, 21.

[15] Whereas the standard decision-making procedure laid down by the TFEU is now by qualified majority, it will only be on the most rare of occasions that the Council decides otherwise than by consensus.

[16] The Union shall replace and succeed the European Community, TFEU, Art. 1(3).

[17] cf. *Opinion 1/78* International Agreement on Natural Rubber [1979] ECR 2871; *Opinion 1/75* Understanding on Local Cost Standard [1975] ECR 1355.

[18] Juan Marchetti and Petros Mavroidis, 'From Reluctant Participant to Key Player: EU and the Negotiations of GATS' in Inge Govaere, Reinhard Quick, and Marco Bronckers, eds., *Trade and Competition Law in the EU and Beyond* (Cheltenham: Edward Elgar, 2011) 48–96.

[19] Ernst-Ulrich Petersmann, 'The GATT Dispute Settlement System as an Instrument of the Foreign Trade Policy of the EC' in Nicholas Emiliou and David O'Keefe, eds., *The European Union and World Trade Law: After the GATT Uruguay Round* (Chichester: Chancery Wiley Law Publications, 1996) 253–77.

[20] Case 8/73 *Hauptzollamt Bremerhaven v Massey Ferguson* [1973] ECR 897; Case 41/76 *Donckerwolke v Procureur de la République* [1976] ECR 1921, *Opinion 1/75* [1975] ECR 1355.

[21] Patrick Messerlin, 'The Influence of the EU in the World Trade System' in Amrita Narlikar, Martin Daunton, and Robert M. Stern, eds., *The Oxford Handbook on The World Trade Organization* (Oxford University Press, 2012) 213–34.

Due to the significantly widened coverage of the WTO Agreement, the ECJ rejected in Opinion 1/94 an interpretation of the CCP—which at the time only mentioned trade in goods—that would have given the Union the exclusive competence for all WTO subject matters, in particular the regulation of trade in services and trade-related intellectual property rights.[22] Rather, from the perspective of EU law, the WTO Agreement had to be concluded as a so-called *mixed agreement*, as the Union was exclusively competent for trade in goods and some aspects of GATS and TRIPS, whereas the majority of General Agreement on Trade in Services (GATS) and Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) regulations still fell within the competence of the Member States.[23]

Accordingly, both the EU and its Member States became original members of the WTO.[24] However, the TFEU now in force (Treaty of Lisbon) has widened the scope of the CCP, and addresses specifically trade in services and intellectual property rights. As a consequence, the competence of the EU under TFEU Article 207 is again in parallel with the subject matter covered by the multilateral trade regime, now administered under the auspices of the WTO.[25] This is an interesting return to the situation which pertained before the conclusion of the Uruguay Round, when the EU had exclusive competence under the CCP for all GATT matters. However, it should be added that for some aspects, residual competences are claimed by the Member States.[26] The fact that

[22] *Opinion 1/94* [1994] ECR I-5276.

[23] Jacques Bourgeois, 'The EC in the WTO and Advisory Opinion 1/94: An Echternach Procession' (1995) *Common Market Law Review* 763–87.

[24] WTO Agreement Arts. IX:1, XII:1.

[25] In Case C-414/11 *Daiichi Sankyo and Sanofi-Aventis Deutschland* [2013] ECR 2013-00000, the ECJ decided that Art. 27 of TRIPs fell within the field of the CCP. In addition, in Case C-137/12 *Commission v Council* [2013] ECR 2013-00000, the ECJ found that the signing of the European Convention on the Legal Protection of Services based on, or consisting of, Conditional Access fell within the exclusive competence of the EU. Furthermore, the CCP now also covers, pursuant to TFEU Art. 207(1), foreign direct investment (FDI). See Marc Bungenberg and Christoph Herrmann, eds., *European Yearbook of International Economic Law, Special Issue: Common Commercial Policy after Lisbon* (Berlin: Springer, 2013) and in particular with regard to remaining Member States' competences: Wolfgang Weiß, 'Common Commercial Policy in the European Constitutional Area—EU External Trade Competence and the Lisbon Decision of the German Federal Constitutional Court' in Bungenberg and Herrmann, eds., *European Yearbook of International Economic Law, Special Issue* (2013) 29 *et seq.*

[26] These alleged competences have so far been irrelevant for WTO practice. They concern inter alia rights emanating from TFEU Art. 79(5) ('This Article shall not affect the right of Member States to determine volumes of admission of third-country nationals coming from third countries to their territory in order to seek work, whether employed or self-employed'). Also with regard to customs administration, Art. 33 ('Within the scope of application of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall take measures in order to strengthen customs cooperation between Member States and between the latter and the Commission') clearly presupposes a degree of Member State autonomy not affected by the exclusive EU competences on CCP and the Customs Union. Another remaining competence of Member States may exist in the areas regulated by TRIPs Art. 41 (enforcement measures); see in this respect the conclusions of the Advocate-General in Case C-13/07 *Commission of the European Communities v Council of the European Union* [2009] who discusses how the obligations pursuant to TRIPs Art. 61 can be implemented. Finally, the various balance of payments exceptions in the WTO Agreement can, at least for those Member States whose currency is not the Euro, only be activated by the Member States themselves, as TFEU Arts. 143 and 144 only regulate the conditions under which such exceptional measures may be taken.

the Member States, and not the Union, finance the WTO has, however, been explicitly rejected by the ECJ as a legal basis for Member State competence.[27]

2.1 Treaty powers of the Union

The Union only has the powers attributed to it by the TEU and the TFEU; matters not attributed to the EU remain within the Member States' competence.[28] For the purposes of current WTO law, the Union has exclusive competence for all matters covered by WTO agreements, with some exceptions related to administrative and criminal law, as well as with regard to services involving the transborder movement of natural persons (mode 4).[29] The TFEU allocates to the Commission the role of proposing internally treaty negotiations and, upon issuance of a mandate by the Council, to negotiate. However, the Member States, and in particular their executives, remain crucial due to their control of the EU Council: the Commission may only engage in negotiations pursuant to a 'mandate' that determines the pertinent terms of reference, and it is the Council which concludes the treaties. Since 2009, this requires prior approval by the Parliament;[30] on that basis, Parliament has successfully acquired an important role already during the negotiations.[31] In addition, the Council and Member States' representatives accompany, via the so-called 'Article 207 committee' all CCP negotiations, both from Brussels and on the spot (*sur place*) and make sure that the negotiating process is in line with the political will of the Council.[32]

Insofar as the WTO is concerned, the central provision authorizing the negotiation and conclusion of multilateral trade agreements is TFEU Article 207(1):

> The common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, foreign direct investment, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies. The common commercial policy shall be conducted in the context of the principles and objectives of the Union's external action.

[27] The ECJ rejected the argument that 'mixity' of the WTO Agreement (which it accepted for other reasons) was a consequence of the fact that Member States contribute to the WTO budget. The Court distinguished the *International Rubber* case (*Opinion 1/78* [1979] ECR 02871), which held that the EC and its Member States enjoyed joint competence in the negotiation of an agreement setting up *a financial policy instrument*, whereas the WTO Agreement entails the obligation to contribute to an operating budget: *Opinion 1/94* [1994] ECR I-5276, at I-5395; cf. Alan Dashwood, 'Mixity in the Era of the Treaty of Lisbon' in Christophe Hillion and Panos Koutrakos, eds., *Mixed Agreements Revisited* (Oxford: Hart Publishing, 2010) 351.

[28] TEU Art. 5(2). [29] cf. TFEU Art. 207(6). [30] TFEU Arts. 218(6), 218(10).

[31] The Parliament has been granted far-reaching concessions by the Commission in the Framework Agreement on relations between the European Parliament and the European Commission [2010] OJ L304; see, however, Council Statement—Framework Agreement on relations between the European Parliament and the Commission [2010] OJ C287/1; see Youri Devuyst, 'The European Parliament and International Trade Agreements: Practice after the Lisbon Treaty' in Inge Govaere, Erwan Lannon, Peter Van Elsuwege, and Stanislas Adam, eds., *The European Union in the World—Essays in Honour of Marc Maresceau* (Leiden; Boston: Martinus Nijhoff, 2014) 171.

[32] TFEU Art. 207(3).

As the competence of the Union is exclusive,[33] Member States are no longer competent to engage in WTO negotiations.[34] This does not mean that Member States have become irrelevant; to the contrary, *their* political will determines what the Union may legally commit to: the Council is composed of Ministers of the Member States and it is the Council that has, by law, the first and last word with regard to foreign relations activities of the Union.

As a consequence of the attribution of external competences to the Union, each time the [Union], with a view to implementing a common policy envisaged by the [TFEU], adopts provisions laying down common rules, whatever form these may take, the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries which affect those rules.[35]

Against this background, the participation of the EU Member States in an eventual conclusion of the WTO negotiating round will require some (internal) legal effort. However, this would seem to be a surmountable obstacle: one possibility is the use of TFEU Article 2(1).[36] In any case, the ECJ mandates 'close cooperation between the Member States and the [Union] institutions, both in the process of negotiation and conclusion and in the fulfilment of the commitments entered into. That obligation flows from the requirement of unity in the international representation of the [Union]'.[37]

2.2 The relationship between WTO law and the legal regime of the EU

International agreements concluded by the Union become an integral part of the EU's legal order, hierarchically positioned between founding treaties (in particular TFEU and TEU) and ordinary ('secondary') legislation.[38] Pursuant to TFEU Article 216(2), agreements concluded by the EU are binding upon both the institutions of the Union and its Member States. This also applies to the GATT and the WTO.[39]

[33] See TFEU Art. 3(1): 'The Union shall have exclusive competence in the following areas: . . . (e) common commercial policy'.

[34] The areas where the Member States remain competent have so far not been the subject of negotiations. Even then, though, the Member States would ask the Commission to represent them.

[35] Case 22/70 *Commission v Council* [1971] ECR 263, 274; cf. TFEU Art. 2(1): 'When the Treaties confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts.'

[36] See Michael Hahn and Livia Danieli, 'You'll Never Walk Alone: The European Union and its Member States in the WTO' in Bungenberg and Herrmann, eds., *European Yearbook of International Economic Law, Special Issue* (2013) 49–63.

[37] *Opinion 1/78*, at I-5420.

[38] The ECJ's pertinent jurisprudence starts with Case 181/73 *Haegeman v Belgium* [1974] ECR 449, which it further developed in Case 104/81 *Hauptzollamt Mainz v C.A. Kupferberg & Cie KG a. A.* [1982] ECR 3641.

[39] Constant jurisprudence since Joined Cases 21 to 24/72 *International Fruit Co. v Produktschap voor Groenten en Fruit* [1972] ECR 1219, where the Court established in the *first part* of the decision that the then Community was bound by the GATT which formed an integral part of the Union legal order; the decision is better known for the rejection of any direct effect in the *second part*, see also Case C-69/89 *Nakajama v Council* [1991] ECR 2069.

On that basis, the Court has deduced an obligation to interpret EU law in light of the WTO obligations in order to ensure, whenever possible, a treaty-consistent interpretation of EU legislation:[40]

> When the wording of secondary Community legislation is open to more than one interpretation, preference should be given as far as possible to the interpretation which renders the provision consistent with the Treaty. Likewise, an implementing regulation must, if possible, be given an interpretation consistent with the basic regulation. Similarly, the primacy of international agreements concluded by the Community over provisions of secondary Community legislation means that such provisions must, so far as is possible, be interpreted in a manner that is consistent with those agreements.[41]

What happens, however, if the efforts to reconcile an EU statute[42] with one of the WTO agreements fail? If the ECJ were to apply its usual *modus operandi*, the answer would be straightforward: as treaties concluded by the EU are an integral part of the Union legal order and occupy a rank above regular ('secondary') laws,[43] the former would have to cede to WTO law, provided it was directly applicable. As the WTO Agreement does not specify whether it ought to be directly applicable or not, it is, according to well-established ECJ jurisprudence, the Court's prerogative to determine whether that effect should be attributed to an agreement. The pertinent track-record of the ECJ would seem to favour the granting of direct effect.[44]

However, individuals and Member States asking for annulment of GATT-incompatible secondary legislation have received different answers. Pursuant to the

[40] cf. Marco Bronckers, 'From "Direct Effect" to "Muted Dialogue": Recent Developments in the European Courts' Case Law on the WTO and Beyond' (2008) *Journal of International Economic Law,* 885, 888.

[41] Case C-61/94 *Commission of the European Communities v Federal Republic of Germany (International Dairy Arrangement)* [1996] ECR I-3989, para. 52; similar passages can be found in Case C-76/00 P *Petrotub SA and Republica SA v Council and Commission* [2003] I-79, para. 57; Case C-431/05 *Merck Genéricos—Produtos Farmacêuticos Ldª v Merck & Co. Inc. and Merck Sharp & Dohme Ldª* [2007] ECR I-7001, para. 35.

[42] Which are called 'regulations' or 'directives' (the latter being framework laws), cf. TFEU Art. 288. With regard to EU secondary legislation implementing international agreements, see Art. 207(2) which is the legal basis for adopting internal implementing measures for international agreements. The provision of Art. 291 regulates the implementing powers of the Commission; cf. Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 that lays down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers [2011] OJ L55, Regulation (EU) No 37/2014 of the European Parliament and of the Council of 15 January 2014 amending certain regulations relating to the common commercial policy as regards the procedures for the adoption of certain measures [2014] OJ L18 and Regulation (EU) No 38/2014 of the European Parliament and of the Council of 15 January 2014 amending certain regulations relating to the common commercial policy as regards the granting of delegated and implementing powers for the adoption of certain measures [2014] OJ L18; see Till Müller-Ibold, 'Common Commercial Policy after Lisbon: The European Union's Dependence on Secondary Legislation' in Bungenberg and Herrmann, eds., *European Yearbook of International Economic Law, Special Issue* (2013) 145–62.

[43] cf. TFEU Art. 288.

[44] See, for example, Case C-327/02 *Lili Georgieva Panayotova and Others v Minister voor Vreemdelingenzaken en Integratie* [2004] ECR I-11055; Case C-265/03 *Igor Simutenkov v Ministerio de Educación y Cultura and Real Federación Española de Fútbol* [2005] ECR I-2579. This even applies to trade agreements; see Case 104/81 *Hauptzollamt Mainz v C.A. Kupferberg & Cie KG a. A.* [1982] ECR 3641, paras. 16, 17. In particular, the Court rejected the argument that direct effect should only be accorded if the other contracting parties would accord the same status in their domestic legal orders. Such a view would, according to the ECJ, not be compatible with a good faith interpretation of an international agreement. The Advocate-General's opinion that the bilateral free trade agreement between the Union and another country was as 'flexible' as the GATT and should not be given direct effect was rejected; ibid. 3674.

Court of Justice's jurisprudence, an international agreement will only be granted direct effect, if its provisions are 'capable of conferring rights on citizens of the Community which they can invoke before the courts.'[45] In its *International Fruit Company* decision of 1972, the Court refused to attribute this quality to *any* provision of GATT. This seems surprising when comparing, for example, the provisions of Article II, III, or XI with similar provisions in the TFEU or in the free trade agreements concluded by the Union which all have been recognized as having direct effect.[46] The Court based its view on the GATT's substantive and procedural flexibility, as manifested in its escape clauses and exceptions and the diplomatic nature of the dispute settlement mechanism.

The ECJ's refusal to attribute even the possibility of direct effect of GATT's multilateral trade law was again put to the test when the WTO came into existence. Several Advocate-Generals expressed the view that the WTO's new Dispute Settlement Understanding (DSU) had changed the factual basis underlying the refusal of granting direct effect to GATT/WTO law.[47] After all, no international dispute settlement procedure comes even close to the WTO's highly effective—and, as we know with the benefit of hindsight, highly successful—dispute settlement mechanism.

However, in its decision to conclude the Uruguay Round agreements, the EU Council—which at that time had the monopoly on deciding whether to enter into a treaty relationship—had stated that 'by its nature the Agreement establishing the World Trade Organization, including the Annexes thereto, is not susceptible to being directly invoked in Community or Member State courts'.[48] Of course, this statement, contained in a piece of secondary law, did not have the legal force to determine how higher-ranked law—such as the Union's primary law—and international law, was to be interpreted by the Union's highest court. Nevertheless, the view of the executive branch that it was not for the EU to grant direct effect when major trading partners, most notably the United States in the Uruguay Round Agreements Act,[49] were refusing to do so, significantly influenced the outcome of the case.

[45] Joined Cases 21, 22, 23, and 24/72 *Int'l Fruit Co. v Produktschap voor Groenten en Fruit* [1972] ECR 1219, para. 8.

[46] Case 104/81 *Hauptzollamt Mainz v C.A. Kupferberg* [1982] ECR 3641.

[47] Opinion of AG Alber of 15 May 2003 in C- 93/02 P *Biret International v Council* [2003] ECR I-10497. On the same lines, AG Tizzano in his Opinion of 18 November 2004 in C-377/02 *Léon Van Parys NV v Belgisch Interventie-en Restitutiebureau* [2005] ECR I-1465.

[48] Council Decision 94/800/EC of 22 December 1994 concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986–1994) [1994] OJ L336, 11th recital in the preamble. This is now becoming a routine clause in the EU's trade agreements, see cf. the decision regarding the signing/conclusion of recent bilateral trade agreements, such as the one with the Republic of Korea (Council Decision 2011/265/EU of 16 September 2010 on the signing, on behalf of the European Union, and provisional application of the Free Trade Agreement between the European Union and its Members States, of the one part, and the Republic of Korea, of the other part [2011] OJ L127, Article 8) and with Colombia and Peru (Council Decision 2012/735/EU of 31 May 2012 on signing, on behalf of the Union, and provisional application of the Trade Agreement between the European Union and its Member State, of the one part, and Columbia and Peru, of the other part [2012] OJ L354/1, Article 7), where the Council added a provision specifying that: 'The Agreement shall not be construed as conferring rights or imposing obligations which can be directly invoked before Union or Member State courts and tribunals'.

[49] See section 4 of this chapter.

In *Portugal v Council,* Portugal sought to annul a Council Decision on market access for textile products originating in India and Pakistan. Deviating from the conclusions of the Advocate-General, the Court reiterated its *International Fruit* jurisprudence that 'the GATT rules are not unconditional and . . . an obligation to recognize them as rules of international law which are directly applicable in the domestic legal systems of the contracting parties cannot be based on the spirit, general scheme or terms of GATT'[50] and applied it without further ado to the WTO agreements, thus rejecting the notion that EU legislation should be subjected by Union courts to the benchmark of WTO law.[51] In its reasoning, the Court relies heavily on its *International Fruit* precedent and questions whether the changes introduced by the DSU have altered the inherently diplomatic nature of the Geneva dispute settlement mechanism.[52] The real reason for its reluctance to recognize direct effect, however, becomes evident when the Court points to the Council statement on direct effect.[53] The Court rightly points out that the Council only followed the example of the Union's major trading partners. As none of them had given direct effect to WTO law, it was not the judiciary's role to weaken the position of Union negotiators by granting third parties a benefit for which other WTO members could arguably extract an additional benefit: contrary to its normal jurisprudence with regard to international treaty law, the Court links reciprocity and direct effect.[54]

Two exceptions to the Court's refusal to grant direct effect should be mentioned for the sake of completeness: if a Union act expresses the Union's intention to implement a particular WTO obligation ('*Nakajima* exception')[55] or if the Union act in question refers to specific provisions of a WTO agreement ('*Fediol* exception'),[56] the Court will review the legality of a Union legislative act or other measure against the benchmark of the WTO Agreement referred to in the Union act. However, as it is in the hands of the Union legislator whether it wants that exposure to additional legal control by the Union courts, those exceptions have proven to be of limited practical relevance.[57]

The ECJ has also rejected giving direct effect to WTO rules as concretized by adopted WTO Panel and Appellate Body Reports,[58] even after the 'reasonable period of time' pursuant to DSU Articles 21.3, 22.2 had expired.[59] The same applies to the DSB decisions.[60] In the absence of judicial adaptation, it is up to the Union legislators to

[50] As restated in Case 280/93 *Germany v Council* [1994] ECR I-4973, at I-5073, para. 110.

[51] Case C-149/96 *Portuguese Republic v Council* [1999] ECR I-8395, 8436–440, paras. 34–48.

[52] Ibid. para. 36 *et seq.* [53] Ibid. para. 48. [54] Ibid. paras. 43–5.

[55] Case C-69/89 *Nakajima All Precision Co. v Council* [1991] ECR I-2069.

[56] See Case 70/87 *Féderation de l'industrie de l'huilerie de la CEE (Fediol) v Commission* [1989] ECR 1781, paras. 19–22 (hereinafter: *Fediol v Commission*). An application of this doctrine is Case C-89/99 *Schieving-Nijstad v Groeneveld* [2001] ECR I-340 (holding that TRIPs Art. 50.6 must be respected by officials of EU/EC Member States).

[57] But see, for example, in Case C-76/00 P *Petrotub SA and Republica SA v Council and Commission* [2003] I-79, paras. 56 *et seq*., 64.

[58] Case C-94/02 *Établissements Biret et Cie SA v Council of the European Union* [2003] ECR I-10565, para. 64 *et seq*.

[59] Case C-377/02 *Léon Van Parys NV v Belgisch Interventie-en Restitutiebureau (BIRB)* [2005] ECR I-1465, para. 51; Joined Cases C-120/06 P and C-121/06 P *Fabbrica italiana accumulatori motocarri Montecchio SpA (FIAMM) and Others v Council of the European Union and Commission of the European Communities* [2008] ECR I-6513, para. 117.

[60] *FIAMM* [2008] ECR I-6513, para. 127 *et seq*.

change EU laws, when and if the DSB accepts report by a Panel or the Appellate Body that views Union law as being not compatible with its obligations under the WTO Agreement.[61]

3. Japan

The Japanese Constitution provides that treaties and established international law should be given due respect.[62] The relevant constitutional provision has been interpreted to signify the supremacy of a treaty or customary international law.[63] Treaties and customary international law should, therefore, prevail over contrary domestic laws.[64] The GATT enjoyed treaty status in the Japanese legal system because it was signed by the Cabinet as a treaty and approved by the *Diet*. The WTO Agreement enjoys treaty status for the same reason. When a conflict arises between a provision in a WTO agreement and a provision of domestic law, the WTO provision should be interpreted as supreme.[65] What is doubtful, however, is whether the WTO agreements have direct effect in the Japanese legal order.[66]

In the *Kyoto Necktie* case,[67] the issue of direct effect of the GATT arose in connection with the 1976 Raw Silk Price Stabilization Law, which established a price-stabilization scheme for domestically produced raw silk.

To effectively operate this price-stabilization programme, it was necessary also to restrict the import of raw silk because the programme would be disrupted if raw silk from abroad were allowed to come in freely when the domestic price was low. Thus, the law was amended to designate a government entity, the Silk Business Agency, as the sole importer of raw silk in Japan. This programme was designed to protect domestic raw silk producers, and the price of raw silk in Japan soared to about twice the world price.

But although raw silk imports were restricted, silk fabric imports were not. As a result, European manufacturers purchased raw silk in China and South Korea, the two major producing countries, and produced silk ties for sale in Japan at low prices.

Japanese fabric producers challenged the Raw Silk Price Stabilization Law under GATT Article XVII:1(a), which stipulates that each contracting party agrees that a state-trading agency under its control should operate its transactions on the basis of

[61] See, for example, Regulation (EU) No 765/2012 of the European Parliament and of the Council of 13 June 2012 amending Council Regulation (EC) No 1225/2009 on protection against dumped imports from countries not members of the European Community [2012] OJ L237, p. 1, through which the adopted reports in the dispute *EC—Fasteners (China)* were implemented.

[62] Kenpō (Japanese Constitution) Art. 98(2).

[63] See, for example, Yuji Iwasawa, 'Constitutional Problems Involved in Implementing the Uruguay Round in Japan' in John H. Jackson and Alan O. Sykes, eds., *Implementing the Uruguay Round* (Oxford: Clarendon Press, 1997) 137, 146.

[64] *Japan v Sakata*, 13 Keishū (Sup Ct Crim Cases Rep) 3225 (Sup Ct, 16 December 1959). In this case, a person was indicted for trespassing on a US Air Force installation in Japan. The indictment was brought under the Criminal Special Measures Law (Law No. 138 of 1952), which provides for the punishment of anyone who trespasses on the property of US bases in Japan, to implement the Status of Forces Agreement and the Security Treaty between the United States and Japan. The defendant's counsel argued that this law, the agreement, and the treaty conflicted with Art. 9 of the Constitution, which prohibits Japan from exercising military power for solving international conflicts. The court allowed the indictment to stand.

[65] Yuji Iwasawa, 'Constitutional Problems Involved in Implementing the Uruguay Round in Japan', in John H. Jackson and Alan O. Sykes, eds., *Implementing the Uruguay Round* (Clarendon Press, 1997), n. 63 at 173.

[66] Ibid. [67] *Endō v Japan*, 530 Hanrei Taimuzu 265 (Kyoto Dist. Ct., 29 June 1984).

commercial considerations only in terms of price, quality, and availability. GATT Article II:4 also stipulates that, whenever a tariff concession under the GATT has been made for a commodity that is an object of state trading, a contracting party shall not sell the commodity in the domestic market at a price above the actual import price plus the applicable tariff.

The Japanese fabric producers argued that the Silk Business Agency was a state-trading agency, and since the agency was not allowed to sell imported raw silk in the domestic market below the stabilization price, the sales policy envisaged in the legislation violated GATT Articles II and XVII.

The Kyoto District Court rejected this argument and gave the following reasons for upholding the validity of the legislation:

> The exclusive importership and the price stabilization system under consideration... are designed to protect the business of raw silk producers from the pressure of imports for a while, and this has the same substance as the emergency measure permitted under article XIX of the GATT. Even though it is reasonable to state that, judging from the nature of such an emergency measure, there should be a limit to the duration of it, such a limit should not be regarded as absolute. Since this duration should be decided in relation to the duration of the pressure of imports, article 12-13-2 of the law providing for enforcing the exclusive importer arrangement for a while cannot be regarded as unreasonable.

Regarding the effectiveness of GATT Articles in relation to domestic laws, the Court stated:

> A violation of a provision of GATT pressures the country in default to rectify the violation by being confronted with a request from another member country for consultation and possible retaliatory measures. However, it cannot be interpreted to have more effect than this. Therefore, it cannot be held that the legislation in question is contrary to the GATT and null and void.

Thus, the Kyoto District Court denied the direct effect of the GATT in Japanese law and refused to apply the established principle of Japanese constitutional law that treaties may override statutes, even those enacted later in time. The plaintiffs appealed this judgment to both the Osaka High Court[68] and the Supreme Court,[69] but in both instances the appeal was summarily dismissed. The Supreme Court simply approved the reasoning of the lower court.[70]

The validity of the Court's holding on the relationship between the GATT and a domestic regulation is rather dubious. The Court held that the import restriction in question would be held lawful since the same kind of measure would be allowed under GATT Article XIX. However, Article XIX requires that a country invoking a safeguard measure find 'serious injury' caused by an increase in imports. In this case, however, not only was 'serious injury' not found, but there was no procedure in the law to find such an injury.

[68] Judgment of 25 November 1986, Osaka High Court, 634 Hantei 186.
[69] Judgment of 6 February 1990, Supreme Court, 36 Shomu Geppo 2242.
[70] Ibid. 2245.

Moreover, the Court seems to imply that the fact that a domestic law is contrary to a provision of the GATT will not affect the validity of the law in Japan, although it may trigger a request for consultation or even retaliation by another GATT member country. This view seems to ignore the relevant provision of the Constitution, which provides that a treaty and established rules in international law should be accorded due respect, as well as the established legal interpretation in Japan that a treaty overrides a contrary domestic law regardless of the order in which the treaty and the domestic law were enacted.[71]

Nevertheless, the decision of the Kyoto District Court in the *Chinese Silk* case is remarkably consistent with similar cases interpreting the GATT in the European Union and the United States. In Japan, in spite of the Constitution, which gives primacy to international law, WTO law will not be accorded direct effect, and, in the event of conflict with domestic law, the domestic law will prevail.

4. The United States

4.1 Overview of US law

A treaty binding the United States under international law will typically be called either a 'treaty' or an 'executive agreement' pursuant to US law.[72] For the purposes of US constitutional law, a 'treaty' is ratified by the President after receiving the advice and consent of two-thirds of the members of the US Senate.[73] The President alone, in contrast, can conclude an executive agreement.[74] In the context of trade agreements, this executive agreement power normally stems from an authorization by Congress, either granted before negotiations or granted after having taking note of the negotiation results.[75] The President also has 'inherent power' of uncertain scope to enter into executive agreements.[76] The power to conclude executive agreements is not explicit in the US Constitution, but has developed in state practice and has received approval by the US Supreme Court.[77] The choice of when to use the treaty power or when to use the executive agreement power is unclear under present constitutional doctrine.[78] In practice, the President makes the choice, but this is often the subject of controversy.[79]

[71] Kenpō, n. 62 at Art. 98, para. 2.

[72] Restatement (Third) of the Foreign Relations Law of the United States, § 111 (1987) (hereinafter: Restatement).

[73] US Const. Art. II, § 2.

[74] *United States v Belmont*, 301 US 324 (1937); *United States v Pink*, 315 US 203 (1942).

[75] See John H. Jackson, William J. Davey, and Alan O. Sykes, *Legal Problems of International Economic Relations: Cases, Materials and Text of National and International Regulation of Transnational Economic Relation*, 5th edn. (Thomson/West, 2008) 97–9 and the two most instructive memoranda to Ambassador Michael Kantor, US Trade Representative, from Walter Dellinger, Assistant Attorney General, Office of Legal Counsel, re: *Whether the GATT Uruguay Round must be Ratified as a Treaty*, sent on 29 July and 22 November 1994 (published, inter alia, at <http://www.justice.gov/olc/gatt.htm#N_2_>).

[76] See ibid. [77] See cases cited in n. 15.

[78] See US Dept of State, *Handbook on Treaties and Other International Agreements* (1985) para. 721.3.

[79] When the WTO Agreement was submitted to Congress as an executive agreement, many argued that it should be submitted as a treaty under US law. See The World Trade Organization and US Sovereignty: Hearings Before the Senate Comm. on Foreign Relations, 103d Cong. (1994). However, the President's power to conclude a trade agreement was upheld in court. *Made in USA Foundation v United States*, 56 F. Supp 3d 1226 (N.D. Ala. 1999).

In the United States, trade agreements are virtually always treated as executive agreements, and, after the conclusion of the Uruguay Round, the President chose to treat the WTO Agreement as an executive agreement. Congress had authorized the negotiation and approval process in advance under a procedure known as 'fast track'. Under the fast-track process, Congress approved legislation authorizing the President to enter into trade negotiations and agreed to consider the necessary implementing legislation under a special legislative process.[80] The process was as follows. First, the bill implementing the executive agreement could not be amended once it was introduced. Second, the appropriate legislative committees and Congress had to vote on the bill within a certain period. Third, the bill would be voted 'up' or 'down' by each House of Congress. The Uruguay Round results were approved, pursuant to this process, through the approval of the Uruguay Round Agreements Act (URAA) in December 1994.[81]

The function of the US 'fast-track' procedure for international trade agreements is not only to facilitate Congressional review and approval, but also to reassure negotiating partners that any trade agreement they negotiate with the United States will not be subjected to Congressional amendments that would necessitate the relaunch of the complex (and often multilateral) negotiation process. Fast-track authority, most recently called 'trade promotion authority', is therefore essential for the President to even engage in serious trade negotiations.

4.2 The relationship between WTO law and US law

Do the WTO agreements have direct effect in the domestic legal order of the United States? US constitutional practice recognizes a distinction between self-executing and non-self-executing international agreements. Both treaties and executive agreements can be self-executing,[82] in which case, they have direct effect as part of US domestic law because of the constitutional provision that 'treaties', together with the Constitution and US laws, shall be 'the Supreme Law of the land'.[83]

Whether a particular treaty is self-executing is a matter of considering the terms in question. If the terms of a treaty give it direct effect, the treaty is self-executing. If the terms indicate that further legislation is needed for direct effect, the treaty is non-self-executing.[84] In addition, some provisions of a treaty may be self-executing, while other provisions are non-self-executing. In US law, multilateral trade agreements such as the GATT have never been held to be self-executing, and leading scholars agree that the GATT is a non-self-executing agreement.[85]

[80] For a full explanation, see John H. Jackson, 'The Great 1994 Sovereignty Debate: United States Acceptance and Implementation of the Uruguay Round Results' (1997) *Colum. J. Transnat'l L.* 37, 157, 168–9.

[81] The Uruguay Round Agreements Act (URAA), Pub.L. 103–465, 108 Stat. 4809, enacted December 8, 1994.

[82] See *Foster v Neilson*, 27 US 253, 314 (1929); *United States v Pink*, n. 74. See also Restatement, n. 72, § 111.

[83] US Const. Art. VI, § 2.

[84] *Foster v Neilson*, n. 82; see John H. Jackson, 'Status of Treaties in Domestic Legal Systems: A Policy Analysis' (1992) *Am. J. Int'l L.* 86, 310, 320.

[85] John H. Jackson, 'The General Agreement on Tariffs and Trade in United States Domestic Law' (1967) *Mich. L. Rev.* 66, 249; Robert E. Hudec, 'The Legal Status of GATT in the Domestic Law of the United States' in Meinhard Hilf, Francis G. Jacobs, and Ernst-Ulrich Petersmann, eds., *The European Community and GATT* (Kluwer, 1986) 187; Ronald A. Brand, 'The Status of the General Agreement on Tariffs and Trade in United States Domestic Law' (1990) *Stan. J. Int'l L.* 26, 479.

In the URAA, Congress settled the question of direct effect: section 102 of the Act provides that 'no provision of any of the Uruguay Round Agreements, nor the application of any such provision to any person or circumstance, that is inconsistent with any law of the United States shall have effect'.[86] This provision means that the WTO agreements have no direct effect in the US legal order.

This provision also means that decisions rendered by WTO dispute settlement Panels and the Appellate Body have no direct effect on US law. The URAA thus confirmed the *status quo ante*. In *Footwear Distributors and Retailers of America v United States*,[87] the US Court of International Trade refused to give direct effect to a GATT Panel decision: 'However cogent the reasoning of the GATT panels . . . , it cannot and therefore does not lead to the precise domestic, judicial relief for which the plaintiff prays'.[88] The US Court of International Trade has also concluded that WTO dispute settlement reports have no binding effect on a US court.[89]

Because neither the WTO agreements nor dispute settlement decisions can directly affect existing US law, it follows that laws passed by Congress after the WTO Agreement and the URAA will be given full effect in domestic law and US courts, even if there is a conflict between such laws and a WTO agreement. US courts have noted that an unambiguous US law prevails over international law in the event of a conflict between the two.[90] However, US courts will not lightly come to such a conclusion, as they subscribe to the view that, 'absent express language to the contrary, a statute should not be interpreted to conflict with international obligations'.[91]

With regard to *US state law*, the URAA similarly provides that:

> No State law, or the application of such a State law, may be declared invalid as to any person or circumstance on the ground that the provision or application is inconsistent with any of the Uruguay Round Agreements, except in an action brought by the United States for the purpose of declaring such law or application invalid.[92]

Thus, while under US constitutional law even an executive agreement based solely upon the President's foreign affairs power prevails over inconsistent state law, a US official or court can declare state law that conflicts with the United States' WTO obligations invalid, if the federal government has brought an action.[93]

The United States has thus adopted a dualistic approach to the WTO Agreement. From the US constitutional perspective, the WTO Agreement is an executive

[86] 19 U.S.C.A. § 3512(a)(1) (1999). See also U.S.S. Rep. No. 103–412, at 13 (1994) (noting that the Uruguay Round Agreements 'are not self-executing and thus their legal effect in the United States is governed by implementing legislation').

[87] *Footwear Distributors and Retailers of America v United States*, 852 F. Supp 1078 (Ct. Int'l Trade 1994).

[88] Ibid. 1096.

[89] See *Hyundai Electronics Co. v United States*, 53 F. Supp 2d 1334, 1343 (1999).

[90] See, for example, *Hyundai Electronics Co.*, 1343.

[91] See, for example, *Hyundai Electronics Co.*, 1344 (citing *Murray v Schooner Charming Betsy*, 6 US (2 Cranch) 64 (1804)).

[92] 19 U.S.C.A. § 3512(b)(2) (1999).

[93] GATT Art. XXIV:12 requires contracting parties to take 'reasonable measures' to ensure observance by local and regional governments. This provision has generated an ambiguous jurisprudence in the United States. For a thorough summary and analysis, see Hudec, 'The Legal Status of GATT', n. 85 at 219–25. Now, WTO Agreement Art. XVI:4 mandates conformity of all US domestic legislation (both at federal and state level) to the WTO agreements. See 19 U.S.C.A. § 3512(c) (1999) (implementing this obligation into US law).

agreement and constitutes a binding international obligation of the United States. It is not directly effective, however, in the domestic legal order. Its implementation depends upon its transformation by the US Congress into domestic law. No private claimant may assert any cause of action or defence directly under any of the WTO agreements before a US tribunal.[94] Thus, in the United States, the legal issues arising under the WTO agreements will be decided under US legislation, both federal and state, regardless of whether the result is consistent with international law. It is the responsibility of Congress and the President to ensure conformity between US and WTO law.

5. Conclusion

As the foregoing suggests, the European Union and United States, for very different reasons, have a complex relationship between their domestic legal systems and WTO law. Neither of them recognizes the direct effect of the WTO agreements or decisions of the WTO Dispute Settlement Body (DSB). Both require the implementation of WTO norms in their domestic legal orders as a necessary condition for giving internal validity to their internationally legally binding WTO obligations.

In the case of the European Union, this is all the more striking: generally speaking—that is, with the most notable exception being the WTO Agreement—the European Court of Justice allows individuals to invoke provisions of international agreements, even if this is not reciprocated by the other contracting party.[95] Time and again, this has resulted in 'ordinary' laws being declared invalid, due to the well-established hierarchical positioning of international agreements in the EU legal order below the constitutional (TFEU and TEU) but above the ordinary law sphere.[96]

Japan provides another example of the difficulty many WTO members have in reconciling their principled position that international treaties take precedence over domestic laws from the day of their enactment or approval[97] with the real world where, as we have learned from the Appellate Body, people 'live, work, and die' and states do not want the Appellate Body to limit their foreign economic policy more than it already does. The cases of the United States, Japan, and the EU show that WTO norms will only be applied by domestic courts after internal implementation and that direct effect of DSB decisions in the domestic legal orders of WTO members is—to the best of our knowledge without exception—not recognized.

[94] 19 U.S.C.A. § 3512(c) (1999).

[95] cf. Case C-327/02 *Lili Georgieva Panayotova and Others v Minister voor Vreemdelingenzaken en Integratie* [2004] ECR I-11055; Case C-265/03 *Igor Simutenkov v Ministerio de Educación y Cultura and Real Federación Española de Fútbol* [2005] ECR I-2579.

[96] cf. Case C-344/04 *The Queen on the application of: International Air Transport Association and European Low Fares Airline Association v Department for Transport* [2006] ECR I-403, at para. 35: '[TFEU Art. 216(2), ex-] Article 300(7) EC provides that "agreements concluded under the conditions set out in this Article shall be binding on the institutions of the Community and on Member States". In accordance with the Court's case-law, those agreements prevail over provisions of secondary Community legislation'. Decision C-61/94 *Commission v Germany* [1996] ECR I-03989, which the Court referred to, had stated, at para. 52: 'Similarly, the primacy of international agreements concluded by the Community over provisions of secondary Community legislation means that such provisions must, so far as is possible, be interpreted in a manner that is consistent with those agreements.'

[97] See, for example, Constitution of Costa Rica Art. 7.

3

Sources of Law and Principles of Interpretation

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1. Introduction

The term 'sources of law' usually refers to the law governing relations among parties to a contract.[1] The parties to a contract (agreement) themselves have the power to identify the law that an adjudicator whom they appoint will apply to their relationship, when warranted. With the exception of *jus cogens*, from which no deviation is allowed, states have complete contractual autonomy to determine the law that will regulate their relations.

The WTO is an organization based upon an international contract among sovereign states and customs territories that enjoy sovereignty in designing their trade policies. WTO members are bound not only by WTO law, but also by a panoply of other customary and conventional international law, which is not necessarily symmetric for all of them. The focus of this chapter is not the law that governs their behaviour in international relations in general, but rather the law that they are obligated to observe by virtue of their WTO membership: this is what the term 'sources of law' aims to capture. Through the WTO Dispute Settlement Understanding (DSU), the WTO members (principals) have provided WTO 'courts' (agents), that is, WTO Panels and the Appellate Body (AB), with the authority to interpret the agreed sources of law. Agents must, in turn, perform their tasks without undoing the balance of rights and obligations as struck by the principals: this is the clear directive of DSU Article 3.2.

[1] This chapter is based on Petros C. Mavroidis, 'No Outsourcing of Law? WTO Law as Practised by WTO Courts' (2008) *American Journal of International Law* 102, 421–74. It has been modified though, substantially in parts, and of course updated to account for events that occurred after publication of the article and before April 2015.

Nowhere in any WTO agreement, however, is there an explicit statement defining the sources of WTO law in a detailed manner. The DSU limits the jurisdiction of WTO dispute settlement bodies to disputes concerning the 'covered agreements' specified in its Appendix 1.[2] Does the term 'covered agreements' extend to the various 'Understandings' agreed during the Uruguay Round? Does it also cover the various decisions and recommendations issued by the various WTO organs? These are legitimate questions that one might raise, and we will be discussing these in the material that follows.

It is clear that the covered agreements that appear in Appendix 1 of the DSU[3] include, through incorporation, provisions of various other international agreements, which should also be regarded as sources of WTO law. The covered and incorporated agreements, as described above, do not exhaust the WTO sources of law. We will argue in this chapter that there are additional sources of WTO law, namely:

(a) state practice;
(b) secondary law; and
(c) implied powers of WTO adjudicating bodies.

With respect to state practice, we should state at the outset that we are interested in 'common' state practice. In this vein, a plausible case can be made that GATT Article XXIX has fallen into desuetude as a result of state practice. This provision requires that WTO members observe certain chapters of the Havana Charter, pending the acceptance of the latter and the establishment of the International Trade Organization (ITO). The ITO never came into being, and it seems certain that it will not: the advent of the WTO on 1 January 1995 *ipso facto* means that the ITO is no longer relevant. In the 1960s and 1970s, many of the countries that had acceded to the GATT had no domestic competition law and were engaging, as is widely reported in the literature, in restrictive business practices, thus violating the letter and the spirit of Chapter V of the Havana Charter, one of the chapters that they were supposedly expected to observe by virtue of GATT Article XXIX. Still, no complaint has ever been filed alleging a violation of this provision. Thus, the evidence suggests that in WTO state practice, the provision is legally inoperative.[4] State practice, we can conclude, has relegated this source of law into desuetude.

With respect to secondary law,[5] the covered agreements themselves establish a series of WTO organs and provide them with the legal capacity to create law. Article IX of the Agreement Establishing the WTO, for example, states that the WTO members

[2] DSU Arts. 1, 2, and 3.

[3] Besides the multilateral agreements (GATT, GATS, TRIPs, DSU, TPRM), and the Understandings and Declarations annexed to them, the framers have added four plurilateral agreements that were in force on 1 January 1995, and that bind a subset of the WTO membership only (those that accepted to adhere to these arrangements). The WTO AB has, from early on, construed all of the multilateral covered agreements as one agreement, that is, the WTO Agreement and its annexes.

[4] The WTO Panel on *Mexico—Telecoms* (§ 7.236) emerges as the only instance where a Panel drew on this provision. It did not find that a violation of GATT Art. XXIX was committed, and cast doubt on its continuing relevance.

[5] Wolfgang Benedek appears to have been the first to use the term *secondary law* to describe a series of consensus-based decisions by the GATT contracting parties, see Wolfgang Benedek, *Das GATT aus Völkerrechtlicher Sicht* (Heidelberg: Springer Verlag, 1990).

can, through joint action, adopt interpretations of the existing legal framework, and Article X of the same Agreement provides that members can, through joint action, adopt amendments of the WTO Agreement. Indeed, the road to adopting the first ever WTO amendment has been opened, following a decision by the WTO General Council to amend TRIPs Article 31. The power to adopt interpretations or amendments is conferred, by virtue of these provisions, to the highest organs established, the WTO Ministerial Council and General Council. The work of the various lower in hierarchy WTO bodies, the 'WTO Committees', such as the Antidumping Committee, which meet and often adopt decisions and recommendations that could be of general applicability, raises the question whether they themselves have the power to create law. WTO case law has provided some responses to this effect as we will see later. Suffice to state for now that legal effects have been recognized to the output of similar bodies.

In some situations the framers have not explicitly provided an organ with the power to regulate specific issues; unless though, 'implied powers' are recognized, the organ in question cannot fulfil its function. The DSU does not explicitly regulate how to allocate the burden of proof, but Panels and the AB needed to address that issue early in their history, otherwise, they would have found it impossible to honour their mandate:[6] in *US—Wool Shirts and Blouses*, the AB allocated the burden of proof by referring to general principles of law. The implied powers to do so arguably stem from DSU Article 11, which imposes a duty to make an 'objective assessment' but does not itself explicitly refer to issues such as allocating the burden of proof.[7]

It would be incorrect to infer, however, that any gap-filling exercise is a source of law. The AB's findings in *US—Wool Shirts and Blouses* concerning burden of proof were intended to be normative rather than case-specific: the allocation of burden of proof should not change based on the identity of the parties. More generally, implied powers by the WTO adjudicating bodies should be limited to certain procedural rights and obligations that are necessary for the WTO membership to be in position to exercise its substantive rights. When exercising their 'implied powers' in other words, WTO 'judges' cannot undo the balance of rights and obligations as agreed by the framers (DSU Article 3.2).

Finally, the sources of WTO law are often not self-explanatory. WTO adjudicating bodies, which are requested to interpret them, often need to rely on various interpretative elements in reaching their conclusions. In order to ensure that their recommendations and rulings will not exceed these bounds, DSU Article 3.2 specifies the interpretative method that adjudicating bodies must use: they must reach their interpretations using 'customary' rules of interpretation. WTO adjudicating bodies have understood this provision to be an implicit reference to the relevant provisions of the Vienna Convention on the Law of Treaties (VCLT).

[6] Lorand Bartels, 'Applicable Law in WTO Dispute Settlement Proceedings' (2001) *Journal of World Trade* 35, 499ff., was the first to make this point.

[7] Gabrielle Marceau, 'WTO Dispute Settlement and Human Rights' (2002) *European Journal of International Law* 13, 753ff., advances a series of arguments in favour of this approach.

Recourse to the VCLT accomplishes two important functions:

(a) It is the road map to identifying the interpretative elements that have been used in order to understand the precise meaning of the often open-ended sources of law: for example, unless we look at subsequent practice regarding the understanding of terms such as 'period of investigation', we have no idea what the maximum duration should be.
(b) It provides a hierarchy of the WTO practice in the widest possible sense, for example, Committee decisions, Panel and AB reports, etc.: by classifying, say, a negotiating document under 'supplementary rules of interpretation', a WTO Panel will make future recourse to it optional for subsequent Panels dealing with the same issue.

The VCLT also opens the door to use of law concluded outside the four corners of the WTO. Article 31.3 allows for the use of any relevant rule of international law when interpreting an international contract. The key, however, is that similar laws can be used to interpret a contract, as they cannot constitute an additional source of law. Trachtman[8] has correctly emphasized the distinction between 'interpretation' and 'application' of law: if, for example, the WTO AB were to use a multilateral environmental agreement (MEA) to make the point that sea turtles are an exhaustible natural resource, it should not, according to this distinction, be applying the MEA provision in a dispute between two WTO members; it should be simply interpreting GATT Article XX(g), using the MEA as an interpretative element of a term that features in that provision. This approach is very much in line with the one advocated in the DSU (Article 3.2).

2. Sources of Law Applicable in WTO Adjudication

2.1 The covered agreements

Appendix 1 to the DSU includes an exhaustive list of all covered agreements, that is, the Annex 1A agreements, the GATT (General Agreement on Tariffs and Trade), and all agreements signed during the Uruguay Round, the Annex 1B agreements, the GATS (General Agreement on Trade in Services) and its Annexes, the TRIPs (Trade-related Intellectual Property Rights), the DSU, and the Plurilateral Agreements (two of which continue to be in force, namely the Agreement on Government Procurement, and the Agreement on Civil Aviation). The texts of several WTO agreements explicitly refer to other international agreements, which are therefore sources of WTO law.

The Havana Charter: Portions of the Havana Charter were incorporated into the GATT through GATT Article XXIX, but this provision appears to have fallen into desuetude. Moreover, the Panel on *Mexico—Telecoms* used Article 46 of the Havana Charter to inform its understanding of the term 'anti-competitive practice'. When doing so though, the Panel made it clear that it was using the relevant provision of the

[8] Joel P. Trachtman, 'The Domain of WTO Dispute Resolution' (1999) *Harvard Journal of International Law* 40, 333ff.

Havana Charter as a 'supplementary means of interpretation' and not as a source of law applicable in adjudication. There is no other case law on this point. It follows that, based on this, the incorporation of various of its Chapters in the GATT notwithstanding, the Havana Charter should not be considered as a source of law, that is, a source of rights and obligations for WTO members.

Agreements mentioned in the TRIPs Agreement: The agreements mentioned in the body of this Agreement (Article 1.3) include major international intellectual property conventions, the Paris Convention (1967), the Berne Convention (1971), the Rome Convention, and the Treaty on Intellectual Property in Respect of Integrated Circuits; for example, TRIPs Article 9 requires that WTO members comply with Articles 1 to 21 of the Berne Convention.

Agreements mentioned in the SCM Agreement: The WTO Agreement on Subsidies and Countervailing Measures (SCM) provides that government grants of export credits in conformity with the provisions of the Arrangement on Guidelines for Officially Supported Export Credits (Arrangement on Guidelines) of the Organisation for Economic Co-operation and Development (OECD) shall not be considered export subsidies. Annex I(k) of the SCM Agreement states:

> [I]f a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

The 'international undertaking' described is the OECD Arrangement on Guidelines; by virtue of its incorporation, it is, of course, a source of WTO law.

Other international agreements: GATT Article XV.6 refers to the obligation of WTO members either to become members of the International Monetary Fund (IMF), or to enter into a special exchange agreement with the GATT contracting parties. In general, this provision recognizes a special consultative role for the IMF in case a WTO member wishes to justify its restrictions on grounds coming under the Fund's competence. This discipline has largely been overtaken by the agreement between the WTO and the IMF discussed below.

Now, what about amendments to agreements that have been incorporated by reference into the WTO? What if similar amendments are decided by a subset of the WTO membership? Should they bind all WTO members? The Panel on *US—Section 110(5) Copyright Act* made clear that WTO members have to observe the incorporated provisions of the Berne Convention:

> [T]he substantive rules of the Berne Convention (1971), including the provisions of its Articles 11*bis*(1)(iii) and 11(1)(ii), have become part of the TRIPS Agreement and as provisions of that Agreement have to be read as applying to WTO Members.

Because they have been incorporated into the TRIPs Agreement, similar provisions cannot be modified or amended in a way that has effect within the WTO system of adjudication, absent a modification or amendment of the TRIPs Agreement itself. The

same Panel discussed the legal relevance of a report adopted in connection with, and subsequent to, the conclusion of the 1971 Berne Convention, which, as noted earlier, is of direct relevance to the interpretation of the TRIPs Agreement. In that case, the Panel was asked to interpret the term 'minor exceptions' appearing in Articles 11(1) and 11*bis* (1) of the Berne Convention. The Panel noted that parties to the Convention had requested that their general rapporteur review the issue. Though not inserted as an amendment to the Convention, the rapporteur's report was adopted by the contracting parties. The adoption predated the entry into force of the WTO Agreement. The adoption in itself sufficed for the WTO Panel to consider the report as a 'subsequent agreement' between the parties (to the Berne Convention and not the WTO) in accordance with VCLT Article 31.2(a).

Item (k) of Annex I of the WTO SCM Agreement refers to:

> an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members).

The lack of explicit reference notwithstanding, it has been understood that the reference in item (k) is to the OECD Arrangement on Guidelines. In *Brazil—Aircraft (Article 21.5—Second Recourse)*, the Panel faced, inter alia, the following question: is the OECD arrangement of 1998 (the amendment to the arrangement incorporated in the SCM Agreement), which had been negotiated only among OECD members, that is, among only a small minority of WTO members, binding on the WTO membership? The Panel decided that, because of the reference in item (k) to the 'successor undertaking', it also had to take into account the 1998 arrangement.

Even the preparatory work of the incorporated agreements has been of legal relevance in WTO proceedings: the Panel on *Canada—Pharmaceutical Patents* took into account the preparatory work of the Berne Convention to clarify the meaning of a condition included in a TRIPs provision that it was called on to interpret. In justifying its choice, the Panel noted that the text of the condition in question was clearly drawn from the Berne Convention (§7.70).

2.2 Secondary law

2.2.1 Interpretations, waivers, amendments

The WTO membership can, by virtue of Article IX:2 of the Agreement Establishing the WTO, adopt interpretations of the Agreement by a three-fourths majority. Recourse to majority voting might be warranted in cases where consensus has not been reached. In practice, however, WTO members vote only when they decide whether to grant waivers. Although the WTO Agreement does not specifically address the issue of the legal value of similar interpretations, there should be no doubt that they are binding on WTO members and on WTO adjudicating bodies as well. Indeed, as will be shown below, WTO adjudicating bodies have not questioned the legality of waivers adopted following the same voting procedures (three-fourths of members). Moreover, there is case law suggesting that waivers are justiciable, and that they constitute the legal (lawful) benchmark to decide whether actions by parties that benefit from them are

lawful or not. Case law has clarified that WTO adjudicating bodies have the right to review whether certain actions taken by WTO members are covered by a waiver or not; during the *EC—Bananas III* litigation, both the Panel and the AB considered the scope of the waiver granted originally by the GATT General Council, which then extended the waiver to the EU in relation to the Lomé Convention. The EU and the African, Caribbean, and Pacific (ACP) countries had argued that the Panel should defer to the interpretation advanced by the EU and the ACP, who, as parties to the agreement, were the only legal persons competent to interpret it (§§7.95 to 7.97). The Panel disagreed. It noted that the EU and the ACP countries had initially been granted a waiver by the GATT, allowing the preferential treatment granted by the former to the latter. That waiver was subsequently extended to the EU and ACP countries through action by the WTO General Council. In the Panel's view, the waiver itself was a WTO decision that, as such, could be reviewed by a WTO Panel. The AB affirmed, observing (§169):

> To determine what is "required" [that is, the scope of the waiver] by the Lomé Convention, we must look first to the text of that Convention and identify the provisions of it that are relevant to trade in bananas.

with the consequence that Panels are competent to review whether actions correspond to the terms and conditions included in waivers authorizing deviations from the WTO Agreement.

Similar conclusions can be drawn with respect to amendments under Article X of the Agreement Establishing the WTO: the provisions of the covered agreements can be amended by consensus or, in the absence of consensus, by various majority rules, depending upon the particular provision in question. On 6 December 2005, the WTO General Council opened the way for the adoption of the first (and, so far, only) amendment.[9]

2.2.2 Decisions and recommendations by WTO organs

The Agreement Establishing the WTO does not provide an exhaustive list of all its organs: Article IV, which reflects the structure of the WTO, does not explicitly refer to Panels, the AB, or committees, such as the Antidumping Committee. The Agreement also does not specify when WTO organs will issue a 'decision' and when a 'recommendation', and it does not even explain the difference between the two.[10] These terms are nevertheless reflected in many working procedures of various WTO committees and are often used in the titles of adopted acts.

Article IV.5 of the Agreement Establishing the WTO mentions, in addition to the Ministerial Conference and the General Council, three other councils (GATT, GATS,

[9] General Council Decision, Amendment of the TRIPS Agreement, WTO Doc. WT/L/641, of 8 December 2005. Through the new Art. 31 *bis*, WTO members, once the amendment has been formally adopted, could outsource production of goods coming under compulsory licensing. It should be noted that the amendment has not (at the time of writing) been formally adopted; adoption would require, under Art. X:3 of the WTO Agreement, a vote of two-thirds of the WTO members.

[10] There is one exception: Art. IX:4 refers to the 'decision' to grant a waiver.

and TRIPs), and Article IV.6 makes it clear that these three councils can, when required, establish subsidiary bodies that can and do adopt decisions. Other subsidiary bodies, such as the WTO Committee on Antidumping Practices (ADP Committee), are provided for in the relevant agreements. These organs have decision-making powers. For example, Rule 33 of the Working Procedures of the ADP Committee reads:

> [W]here a decision cannot be arrived at by consensus, the matter at issue shall be referred to the Council for Trade in Goods.

Besides standing bodies, like for example the ADP Committee, we have seen ad hoc bodies being set up to deal with one specific issue. The Working Group on the Interaction between Trade and Competition Policies is a good example. It was established in order to explore whether the WTO should expand its mandate to cover competition policies as well. It was discontinued following the decisions adopted at the Cancun Ministerial Conference (2003).

Not every decision by each and every WTO organ is of regulatory character. To take just one instance, even a cursory look at the Working Procedures of the Antidumping Committee suggests that much of its activity is not of normative character. But some of it is. For example, the period of investigation during which a domestic investigating authority must establish dumping and measure injury is nowhere defined in the Antidumping Agreement (AD Agreement). The ADP Committee has filled the gap and recommended the total length for the period of investigation (POI) that WTO members should use in determining dumping and injury. In light of the committee's wide mandate (AD Article 16), it would appear perfectly legitimate for the ADP Committee to adopt recommendations to this effect.

So what is the legal value of such acts? Over the years, WTO adjudicating bodies have taken a friendlier attitude toward decisions and recommendations adopted by WTO organs (for example, committees). One of the first pronouncements to this effect came by the Panel on *India—Quantitative Restrictions*, where the Panel stated that, if the committee (in the case at hand, the Committee on Balance of Payments) had already decided the issue before the Panel, it could 'see no reason to assume that the panel would not appropriately take those conclusions into account' (§§5.93 to 5.94). Indeed, the Panel indicated that, depending on the treaty language and the legal powers conferred upon an organ such as the Balance of Payments Committee, it would potentially be legally compelled to do so. Likewise, the Panel on *Mexico—Anti-dumping Measures on Rice* relied (§7.62), in part, on the ADP Committee recommendation on the length of the POI to support its own view as to the period over which to measure injury (injury POI). Along the same lines, the Panel on *EC—Pipe Fittings* based its conclusion that it is desirable that the period to investigate occurrences of dumping (dumping POI) substantially overlap with injury POI on a recommendation by the ADP Committee (§7.321). Likewise, the Panel on *Argentina—Poultry Anti-dumping Duties* relied on the recommendation by the ADP Committee to support its conclusion that the dumping and injury POIs should not necessarily end at the same time (§7.287). Note that the Panel on *India—Quantitative Restrictions* was dealing with a decision by a committee, whereas the other reports mentioned dealt with recommendations.

As things stand, WTO adjudicating bodies seem to treat recommendations by WTO organs as 'supplementary means of interpretation' (when prefacing recourse to them, they use phrases such as 'we find support' or 'our interpretation is confirmed'). Is this classification inappropriate? It is true that a recommendation by the ADP Committee is not an interpretation: Article IX:2 of the Agreement Establishing the WTO reserves the exclusive authority to adopt interpretations to two organs, the Ministerial Conference and the General Council. AD Article 16.1, however, does not preclude the ADP Committee from exercising regulatory functions. Indeed, its mandate as specified in that article is quite open-ended: it 'shall carry out responsibilities as assigned to it under this Agreement or by the Members'. In principle, nothing stops WTO members from delegating regulatory authority at this level. A recommendation like the one on the length of the POI could, for example, serve as a source of law: the Committee dealt for the first time at the multilateral level with an issue not explicitly regulated in the AD Agreement; it used language that makes it clear that it was intended to serve as a guideline; and it was accepted by consensus. A very strong counterargument can be made, however, that ultimately justifies the choice of WTO adjudicating bodies to treat similar recommendations as supplementary means of interpretation and not as sources of law. The General Council has a quorum provision: Rule 16 of its Working Procedures[11] specifically states that the majority of the WTO membership must be present for a quorum. There is no quorum requirement for any of the committees established under the various covered agreements. This difference cannot be accidental. The will of the legislator must have been to associate the General Council meetings with a certain degree of formal significance, whereas the reverse is true for committee meetings. By the same token, the expectation of trade delegates to the WTO must be that 'serious' issues will be discussed at the General Council level, whereas more day-to-day operations will form the subject matter of the committee mandates. Practice in the ADP, but also in other committees, amply supports this view. The recommendation concerning POIs is an exception to the items on typical agenda; normally, delegates will discuss complaints by members, implementation of Panel reports, and so on. Similarly, other committees, such as the Committee on Trade and Environment, will entertain discussions on what is an environmental good or what the link between a multilateral environmental agreement and the WTO should be. The committee will stop short, however, of deciding the issue. This last step is left for higher organs, assuming a consensus has been reached. Strong contextual arguments thus (the identity of the organ adopting a decision or recommendation) support the view that recommendations, such as the one concerning POIs, were correctly treated by Panels as supplementary means and not as a source of law. This solution also has the merit of flexibility: for example, if WTO members are interested in elevating the POI recommendation to a source of law, nothing stops them from including it in the new AD agreement or from adopting an interpretation to that effect.

Note, finally, that one Panel has even reviewed the relevance of an act by a non-standing (that is, an ad hoc, a non-permanent) WTO organ, albeit as a supplementary

[11] WTO Doc. WT/L/28, of 7 February 1996.

means. In its determination that the term 'anti-competitive practice' covered horizontal price fixing, the Panel on *Mexico—Telecoms* relied, in part, on the work of the 'WTO Working Party on the Interaction of Trade and Competition Policies', which the Panel found to be of some relevance. This Working Party was created by the Singapore Ministerial Conference of 1996 and has not met since September 2003, following the decision by negotiators not to renew its mandate. Although the Panel issued no explicit pronouncement to this effect, the context makes obvious that the Panel treated the WTO Working Party report as a supplementary means of interpretation; that is, the Panel referred to the Working Party's work in order to confirm a conclusion that the Panel had already reached (as per VCLT Article 32).

Note also that the attitude of Panels to recognizing the legal effects of acts by lower WTO organs has provoked negative reactions from some WTO members. Article 2.12 of the Agreement on Technical Barriers to Trade (TBT) requests from WTO members to allow a 'reasonable interval' between notification of their proposed technical regulation and its entry into force. In *US—Clove Cigarettes*, the Panel found that a US decision to allow for an interval of three months only was in violation of this provision (§§7.563ff.). To reach this conclusion, the Panel relied on a Decision by the TBT Committee,[12] which had incorporated §5.2 of the Doha Ministerial Decision, which reads in part:

> [T]he phrase "reasonable interval" shall be understood to mean normally a period of not less than 6 months, except when this would be ineffective in fulfilling the legitimate objectives pursued.

In this Panel's view, the Doha Ministerial Decision helped fill a gap in the original text, and hence, should be taken into account. On appeal the AB upheld this finding stating that the Doha Ministerial Decision was a subsequent agreement in the terms of VCLT Article 31.3(a) (§§241ff.).

To recognize the Doha Ministerial Decision as a subsequent agreement is one thing, but to do the same when dealing with a TBT Committee decision is totally different. And yet in its report on *US—Tuna II*, the AB held that a TBT Committee decision stating the six criteria that must be met by 'international standards' was a 'subsequent agreement' in the VCLT sense of the term (§372). This finding did not find favour with some WTO members.

Indeed, the reaction (of some WTO members) was hostile. In a subsequent TBT Committee meeting, some members insisted that, starting immediately, this Committee should make it crystal clear that its output was void of legal consequences, otherwise these members would be opposed to the adoption of common positions.[13]

The DSU, one of the covered agreements, explicitly acknowledges the right of WTO adjudicating bodies to establish their own Working Procedures. DSU Article 17.9 explicitly authorizes the AB to do so (which it has done). Although Panels are required to obey the Working Procedures reflected in Appendix 3 to the DSU, DSU Article 12.1 permits them to deviate if they so choose. The primary law thus acknowledges the right

[12] WTO Doc. G/TBT/1/Rev. 8 of 23 May 2002.
[13] WTO Doc. G/TBT/M/64 of 11 November 2014.

of WTO adjudicating bodies (albeit not the same for all bodies) to legislate in the narrow context of their own procedures.

In addition to the power to enact procedures, WTO adjudicating bodies have on occasion created law in order to be in a position to honour their mandates (implied powers). We offered the example of allocating the burden of proof as evidence, but there are other examples as well: third party rights is an appropriate illustration. Appendix 3 does not mention 'extended third-party rights'. When the first Panel decided on extending the right of third parties so as to allow them to participate in the second substantive Panel meeting, the Panel had to establish criteria to which future interested parties could refer in order to enjoy the same privilege.[14] Yet another example concerns the participation of *amici curiae*. Nothing in Appendix 3 provides for such participation, the conditions for which have been defined, instead, via the case law of the AB and Panels.[15]

2.2.3 International agreements signed by the WTO

The combination of various provisions of the Agreement Establishing the WTO nevertheless leads us to the conclusion that the WTO has treaty-making power. In particular, Article VIII.1 acknowledges that the WTO has legal personality; Article V states that the WTO General Council can make arrangements that will facilitate the cooperation between the WTO and institutions having a related mandate; and Article III.5 explicitly provides for cooperation between the WTO, the IMF, and the International Bank for Reconstruction and Development (the World Bank).

The WTO has, in fact, signed international agreements. Two of them involve, as expected, the Bretton Woods institutions, the agreement between the IMF and the WTO, and the agreement between the World Bank, the International Development Association, and the WTO.[16] These agreements, which were approved by the WTO General Council at its meeting on 7, 8, and 13 November 1996, were intended to strengthen the WTO's relationship with the IMF and the World Bank. The WTO has concluded two more agreements: one with the World Intellectual Property Organization (WIPO)[17] and one with the World Organization for Animal Health (formerly the Office International des Epizooties).[18] The relevance of similar agreements has already been acknowledged in case law. The AB, in its report in *Argentina—Textiles and Apparel*, held that the agreement between the WTO and the IMF is legally relevant but that it does not modify, add to, or diminish the rights and obligations of members (§72).

[14] Essentially, the Panel would first satisfy itself that a third party had an especially strong reason for continuing to participate in a given dispute. The question of enhanced third party rights first arose in *EC—Bananas III*, when a number of developing-country third parties requested that they be permitted to attend all meetings between the Panel and the parties to the dispute, and not simply the first meeting as per DSU Art. 10.3.

[15] For a detailed review of the case law on this score, see Petros C. Mavroidis, 'Amicus Curiae Briefs before the WTO: Much Ado About Nothing' in Armin von Bogdandy, Petros C. Mavroidis, and Yves Meny, eds., *European Integration and International Co-ordination, Studies in Trans-national Economic Law in Honour of Claus-Dieter Ehlermann* (Leiden: Kluwer, 2002) 317–29.

[16] General Council Decision, WTO Doc. WT/L/195 of 18 November 1996.

[17] 35 I.L.M. 754 (1996). [18] WTO Doc. WT/L/272 of 8 July 1998.

This completes our discussion of sources of WTO law. Before we move to review their interpretative elements though, it is appropriate to discuss two additional issues:

(a) the treatment of customary international law warranted; and
(b) the relevance of general principles of international law.

The former was discussed extensively in one Panel report, and we will discuss it below. It is difficult to decide whether general principles of law should be treated as sources of law or as interpretative elements. Some of the general principles mentioned here do interpret the sources of law: *in dubio mitius* amounts to a presumption that no sovereignty has been transferred when the letter of the law is unclear. But some general principles do not have this function: estoppel and *res judicata* do not interpret rules of law, since they only limit the competence of an adjudicating body to decide certain questions. It is the heterogeneity of general principles of law that persuaded us that they should be discussed here as a separate category of law applicable in WTO adjudication.

2.3 The treatment of customary international law in the WTO

The Panel on *Korea—Government Procurement* discussed the relevance of customary international law in the WTO legal order. In particular, this report examined the concept of non-violation complaints in the light of customary international law—and more specifically, in relation to *pacta sunt servanda*.[19] It held:

> Customary international law applies generally to the economic relations between the WTO Members. Such international law applies to the extent that the WTO treaty agreements do not "contract out" from it. To put it in another way, to the extent that there is no conflict or inconsistency, or an expression in a covered WTO agreement that implies differently, we are of the view that the customary rules of international law apply to the WTO treaties and to the process of treaty formation under the WTO.

With this very important statement, the Panel suggested that general customary international law is always relevant unless the covered agreements have explicitly contracted out from it. The natural consequence would be that, since the content of customary international law contains elements additional to WTO contractual rights and obligations, the covered agreements and the incorporated agreements are not the only sources of WTO law. Customary international law must also be considered a source of WTO law.

Similar statements have never been repeated in subsequent case law. Nevertheless, a context-specific reading of this Panel report suggests that its findings were not made

[19] As discussed in detail in Chapter 4, through this instrument, trading nations might be compelled to compensate their (negatively) affected trading partners, even though they have committed no illegality. The leading example is compensation for effects of subsidization: domestic subsidies are not illegal in the WTO legal order, but a nation that subsidizes, say, tomatoes after it has agreed to reduce its import duty on this product, is harming the foreign producer who might legitimately not have expected this subsidy. Compensation in such a case is necessary, not only in order to protect the bona fide trading partner who negotiated the 10 per cent concession, but also because the system wants thus to ensure that the incentive to negotiate further trade liberalization will not be put into question by such (legal) acts.

with respect to an autonomous source of law but with respect to a general principle that has attained the status of customary international law. The overall relevance of customary international law in the WTO legal order has continued to be an active topic in the legal literature. Pauwelyn,[20] for example, advances very good arguments in favour of constructing WTO law as a part of the whole, with the whole being public international law. To the extent that his preferred approach entails using interpretative elements from the wider public international law, then few would argue with it. If, however, the suggestion is that by referring to customary international law, we are looking for autonomous sources of law additional to the covered (and the incorporated) agreements, then the discussion becomes tricky, at least. A primary problem concerns the identification of the relevant customary international law: which customary international law is relevant and to whom? To respond to this question, we need a precise definition of the customary international law (other than *jus cogens*, of course) that binds all 160 current WTO members.

Some of that customary international law has been codified: the VCLT, the UN General Assembly resolution on state responsibility, and the 1982 Convention on the Law of the Sea. The latter could be relevant for example, for the discussion of rules of origin, though at this stage there is nothing like a substantive agreement on rules of origin in the WTO. The General Assembly resolution on state responsibility has been referred to in some WTO disputes and, extensively, in the Arbitrator's report on *US—FSC (Article 22.6—US)*. It has always been used as supplementary means supporting the interpretative decision on remedies, and not as an autonomous source of law. The resolution in question codifies customary international law in the field of state responsibility and is the product of an effort extending over five decades. The International Law Commission's report clarifies numerous issues that were left unspecified in the DSU: for example, retroactive remedies, in the sense that damages will be calculated from the point in time when the illegality was committed, are customary international law, and so is the calculation of both *damnum emergens* (damage already suffered) and *lucrum cessans* (expectation value, forgone gains) as part of the compensation due in case of breach of contract. Nothing, of course, stops the WTO membership from explicitly deviating from customary law (other than *jus cogens*). Indeed, since custom and treaty are of equal value, it is the *lex posterior* principle that will determine which law takes precedence. The WTO membership did not address this issue head on. WTO practice suggests that, contrary to what is the case in customary international law, damages will be calculated from the end of the implementation period and not from the earlier moment when the illegality occurred. Thus, WTO practice did not construct customary international law as a relevant source. Note that in the GATT years, the opposite was (in part) true: Petersmann identifies five cases where retroactive remedies had been recommended.[21] WTO practice though, has moved away from similar pronouncements.

[20] Joost Pauwelyn, *Conflicts of Norms in Public International Law* (Oxford: Oxford University Press, 2003).

[21] Ernst-Ulrich Petersmann, 'International Competition Rules for the GATT–MTO World Trade and Legal System' (1993) *Journal of World Trade* 35, 27ff.; Robert E. Hudec, *Enforcing International Trade Law* (London: Butterworths, 1993); Petros C. Mavroidis, 'Remedies in the WTO Legal System: Between a Rock and a Hard Place' (2000) *European Journal of International Law* 11, 763ff.

The Panel on *EC—Hormones* held the view that, assuming *arguendo* that the precautionary principle is customary international law, it would not override explicit provisions of the covered agreements that were intended to codify it. This conclusion was affirmed by the AB, which noted that the status of the precautionary principle in international law is still very much the subject of debate. The AB also stated that while the precautionary principle might have crystallized into a general principle of customary international environmental law, it is less than clear whether it has been widely accepted as a principle of general or customary international law. At the same time, whether or not the precautionary principle might have that status, the AB ended up stressing its relevance in the interpretation of WTO norms (§§120 to 125).

2.4 General principles of law in the WTO legal order

The Panel on *EC—Pipe Fittings* held that a general principle of law, by its very nature, cannot substitute for a detailed contractual provision (§7.292):

> We are conscious that the requirement in Article 3.1 to conduct an "objective examination" on the basis of "positive evidence" is that the investigating authorities examination . . .

This passage reflects the attitude of WTO adjudicating bodies towards general principles of law. Panels have used general principles in order to interpret various provisions, as this Panel did when interpreting the requirement to perform 'objective examination'. In what follows, we identify the general principles that have been acknowledged as legally relevant in the WTO legal order.

2.4.1 Estoppel

The first comprehensive discussion of 'estoppel' appeared in the GATT Panel report on *US—Softwood Lumber II*: the parties to the dispute (Canada and the United States) had concluded a memorandum of understanding (MOU), and the question, inter alia, before the Panel concerned the extent to which the parties, by signing the MOU, had waived their rights under the GATT and were thus estopped from any further action. Although the Panel discussed this question in its report, it refrained from deciding the issue in light of the dispute's particular factual setting. Because of the extended discussion of this issue, however, it is reasonable to infer that the Panel saw the principle of estoppel as having some relevance within the GATT legal framework.

Since that time, several WTO Panels have discussed estoppel. The first discussion can be found in the Panel report on *Guatemala—Cement II*: after the AB had rejected Mexico's initial complaint, Mexico introduced a new complaint against the same measure. At that point Guatemala argued that Mexico was estopped from pursuing that new complaint. The Panel disagreed, reasoning that the estoppel principle is relevant only if the complaining party had clearly consented to the particular behaviour in question, which Mexico had not (§§823 to 824 and footnote 791).

Along the same lines, the Panel on *Argentina—Poultry Anti-dumping Duties* reviewed the estoppel principle as a source restraining its jurisdiction. Argentina had

argued that Brazil was estopped from submitting their dispute to a WTO Panel since the very same dispute had already been adjudicated by a MERCOSUR panel (the regional integration scheme in which both Argentina and Brazil participate). The WTO Panel dismissed Argentina's argument because, inter alia, in its view, DSU Article 3.2 did not require Panels to rule in any particular way and thus to ensure that their own decisions conformed with those of other adjudicating forums. The Panel did accept, however, the parameters of the estoppel principle as presented by Argentina. In particular, that estoppel applied in circumstances where one party makes a statement that is clear and unambiguous, voluntary, unconditional, authorized, and relied on by the other party in good faith (§§7.37 to 7.38).

More recently, the AB, in its report on *EC—Export Subsidies on Sugar*, had the opportunity to present its views on estoppel. Noting that it had never applied this principle, it took the view that if relevant at all, the principle had been narrowed down to DSU Articles 3.7 and 3.10, which require WTO members to exercise their judgement as to the fruitfulness of submitting a dispute. This analysis by the AB, however, is problematic to say the least. The two provisions cited have nothing to do with the estoppel principle as it is known in public international law. The two DSU provisions in question are conceptualized in terms of cost–benefit analysis, which would probably not be justiciable. How on earth could a WTO judge substitute its own judgement on whether pursuing adjudication is fruitful to that of the interested parties? By contrast, estoppel within public international law is conceived as an obstacle to submitting a claim, irrespective of the outcome of any possible cost–benefit analysis by the potential claimant. As things stand, the only plausible conclusion is that whereas this principle could in principle be relevant in the WTO legal order, it has never been applied so far.

2.4.2 Res judicata

The Panel on *India—Autos* discussed *res judicata* extensively, holding that the principle has its place in the WTO legal order. This Panel made it clear that there are stringent conditions attached to this principle, and that, absent their satisfaction, it cannot be applied. The conditions are (§§7.54 to 7.66):

(a) the measures challenged in the original and the subsequent disputes must be identical;
(b) the claims in the two disputes must be identical as well; and
(c) the parties in the two disputes must be identical.

If these three conditions are cumulatively met, then *res judicata* comes into play. This benchmark is largely consonant with the understanding of this principle in public international law.[22]

[22] The difference between *res judicata* and estoppel is as follows: in the former, the forum is the same (in the original and the subsequent litigation), whereas in the latter, the fora are different, so that a country might be estopped from submitting a complaint before a particular forum because a different forum has already pronounced on the issue.

2.4.3 Error

The Panel on *Korea—Government Procurement* is the only report that contains a comprehensive discussion of error. In that case the United States had claimed that an error on its part had the effect of vitiating its consent to be bound by the terms of the agreement. The Panel discussed whether the error at hand was of such a nature as to accept the US claim that it should not be considered to have given its consent. The Panel concluded that the United States had itself contributed to the error and was therefore obligated to carry out the contractual terms (that is, the error was not excusable). The Panel's entire analysis is predicated on its understanding and interpretation of VCLT Article 48.

2.4.4 Non adimplenti contractus

In *Argentina—Poultry Anti-dumping Duties* Argentina had argued, inter alia, that other WTO members had been practising what Argentina was being accused of, but without being punished. Argentina was arguing, in effect, that it should not be punished since others were also not respecting the relevant portion of the WTO contract. The Panel responded that the dispute before it concerned only Argentina's practices (§7.79):

> Argentina asserts that the methodology used by the [Department of Unfair Trading Practices and Safeguards] has also been used by other WTO Members. Even assuming for the sake of argument that Argentina is correct, this argument is nevertheless irrelevant. In this dispute, we must determine the conformity of Argentina's methodology (and not that of other WTO Members) in light of the relevant provisions of the *[Anti-dumping] Agreement*. (Italics in the original.)

The Panel's interpretation is in fact consonant with the legal nature of the WTO contract. It is a multilateral contract, where the defence of *non adimplenti contractus* has no place, since this principle has, unless explicitly agreed otherwise, its place in bilateral contractual relationships only.

2.4.5 Good faith (bona fides)

Numerous reports refer to the obligation to perform the WTO treaty in good faith, as is also stipulated in VCLT Article 26 (*pacta sunt servanda*). What exactly this obligation entails has nevertheless been discussed only on a few occasions. There is some case law concerning the connection between violations of the WTO Agreement and the principle of good faith. Consider, for example, the Panel on *EC—Pipe Fittings*, where the Panel took the defendant to be acting in good faith even though some confidential information had not been submitted to the Panel, and the reason for not submitting such information had been judged unsatisfactory by the Panel itself (§7.307). Similarly, in *US—Offset Act (Byrd Amendment)*, the AB asserted that a mere violation of a provision of a WTO Agreement does not in and of itself amount to a violation of the

principle of good faith. So far, no WTO case law has suggested that a member may have acted in bad faith (§298).

2.4.6 In dubio mitius

The *in dubio mitius* principle has been invoked in more than one case, the leading case being the *EC—Hormones* AB report (§§154 to 165). There, the AB reversed the Panel's understanding concerning the allocation of the burden of proof when a WTO member deviates from an international standard (of those mentioned in the SPS Agreement). Contrary to what the Panel had held, the AB took the view that an adjudicating body cannot simply assume that, in the presence of two possible readings of the same provisions, WTO members opted for the relatively more onerous of the two. The AB based its conclusion on the maxim *in dubio mitius* (§165):

> We cannot lightly assume that sovereign states intended to impose upon themselves the more onerous, rather than the less burdensome, obligation by mandating *conformity* or *compliance with* such standards, guidelines and recommendations. To sustain such an assumption and to warrant such a far-reaching interpretation, treaty language far more specific and compelling than that found in Article 3 of the *SPS Agreement* would be necessary. (Emphasis in the original.)

Citing numerous public international law books and articles that discuss the principle *in dubio mitius*, the AB also noted that the interpretative principle of *in dubio mitius*, is widely recognized in international law as a 'supplementary means of interpretation'.

The evidence presented above suggests that, in WTO adjudication, general principles of law have been used extensively as interpretative elements for clarifying the scope of the various sources of WTO law.

3. Interpretative Elements (of the WTO Sources of Law)

3.1 The Vienna Convention on the Law of Treaties in the hands of the WTO courts

DSU Article 1 states:

> The rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the "covered agreements").

The standard terms of reference (TOR) for dispute-adjudication are enshrined in DSU Article 7:[23]

> To examine, in the light of the relevant provisions in (name of the covered agreement (s) cited by the parties to the dispute), the matter…

[23] Unless special TOR have been agreed between the parties; an infrequent occurrence: for an example, see the AB report on *Brazil—Desiccated Coconut*.

When called to adjudicate, a WTO adjudicating body must interpret the covered agreements by observing the discipline embedded in DSU Article 3.2:

> The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.

In *US—Gasoline* the AB understood the reference to customary rules of interpretation of public international law to correspond to the rules contained in the VCLT. VCLT Article 31 mentions that a treaty shall be interpreted in accordance with:

(a) the 'ordinary meaning of its terms',
(b) in their 'context',
(c) taking into account the 'object and the purpose of the treaty', as well as
(d) relevant 'subsequent practice',
(e) 'subsequent agreements on the same subject matter', and
(f) 'any relevant rules of public international law applicable in the relations between the parties'.

VCLT Article 32 adds that under specific conditions, recourse to 'supplementary means of interpretation' (including 'travaux préparatoires') can take place.

WTO adjudicating bodies have not relied exclusively on the references explicitly mentioned in the VCLT. In interpreting the covered agreements, they have occasionally used *lex specialis*. This interpretative maxim has not been explicitly included in the VCLT, but it is consonant with the principle of 'effective treaty interpretation' (*ut regis valeat quam paereat*), which provides the cornerstone of the VCLT, that is, the imperative to ensure that some terms should not be interpreted to redundancy as a result of extending the coverage of other terms. Were one not to start from the rule that specifically regulates a particular transaction[24] (and were to privilege, instead, the application of the more general rule), one risks making such specific rules redundant. In the words of the AB in *US—Gasoline* (at 23):

> An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.[25]

In similar vein, the AB used the principle of 'evolutionary interpretation' in *US—Shrimp*. It held that the term 'exhaustible natural resources' should be understood to

[24] Following *EC—Asbestos*, Panels and the AB have, for example, consistently started their legal analysis of measures simultaneously falling under the ambit of both the GATT and the TBT Agreement (Technical Barriers to Trade) from the latter, that is, the agreement that more specifically regulates instruments such as 'technical regulations', and 'standards' which also come under the purview of the GATT, see the Panel reports on *US—Clove Cigarettes*, *US—COOL*, and *US—Tuna II (Mexico)*.

[25] In this vein, the Panel in its report in *Canada—Patent Term* tested whether the interpretation it reached on one TRIPs provision rendered redundant other related TRIPs provisions (§6.50).

cover living organisms (since this term is evolutionary and not static, at least in the eyes of the AB)—and not simply non-living materials, as the negotiating history of GATT Article XX(g) would have probably suggested (§130). This principle could in theory be likened to 'subsequent practice', or even 'subsequent agreement'.[26]

The AB has made reference not only to VCLT Articles 31 and 32, but also to VCLT Article 33, which deals with treaties signed in more than one language: Article XVI of the Agreement Establishing the WTO acknowledges English, French, and Spanish to be authentic languages. But then, which version should be privileged in case of differences in the three texts? VCLT Article 33 stipulates that, in case a treaty has been authenticated in more than one language, the terms of the treaty shall be presumed to have the same meaning in each linguistic version. WTO adjudicating bodies, in the overwhelming majority of the cases, have used English as the working language.[27] There is by now evidence that the AB has sometimes examined the French and the Spanish text to confirm a decision reached using the English text.[28] The AB has further clarified in *US—Softwood Lumber IV* that, in accordance with VCLT Article 33, it should (§59):

> seek the meaning that gives effect, simultaneously, to all the terms of the treaty, as they are used in each authentic language.

This approach would suggest that the treaty interpreter should privilege interpretations that overlap in the three different texts. In its report on *EC—Tariff Preferences* (§147), however, the AB privileged the terms used in the French and the Spanish texts ('as defined'), which, to its own admission, reflected stronger, more obligatory language than the terms used in the English text ('as described').

Interpreting and applying the VCLT is not an exact science, since, depending on the weight one places on one (or more) of its elements, a different outcome is possible. One can also, at least nominally, use all the mandated references while having already decided the issue under one of them. It is not the purpose of our discussion here to evaluate, in great detail, the use of the VCLT by WTO adjudicating bodies. Nevertheless, two conclusions emerge from WTO dispute adjudication practice:

(a) WTO adjudicating bodies have relied heavily on what they understand to be the ordinary meaning of the terms, and much less on elements such as context, state practice, or subsequent agreements;
(b) When in doubt, they prefer to classify interpretative elements under supplementary means. This approach is obviously in line with their incentive structure to maintain maximum flexibility in the future; it is, unfortunately, on occasion, incorrect.

WTO adjudicating bodies have had extensive recourse to dictionary meaning of terms (with a particular inclination to use the *Oxford English Dictionary*). In the past,

[26] Assuming of course that we are talking about the practice of the WTO members, and not simply the judge's view with no empirical support to back it up. In *US—Shrimp*, when invoking 'evolutionary interpretation', the AB did not first check practice by WTO members. In fact, it reproduced the AB members' view on the issue.

[27] *EC—Asbestos* emerges as a notable exception.

[28] *EC—Bed Linen*, AB, §123.

the reader of a report has sometimes been left with the impression that dictionary-based, that is, a-contextual, interpretations have carried too much weight.[29] The ordinary meaning of a particular legal term though, can be understood only as it occurs in a particular sentence, which itself has to be understood and evaluated in the context of the overall contract or agreement to which it belongs. This consequence follows naturally from the realization that words are not invariant or static in meaning (as dictionaries sometimes want them to be), they have a life within a particular integrated context where they are lodged. An inquiry into the context (that is, the rest of the agreement at the very least) will lead the judge to ask two centrally important questions:

(a) What did the framers have in mind when they passed this law?
(b) How did they conceive the realization of their stated objectives?

Contextual interpretations will thus lead the WTO judge to inquire both as to the ends sought and the means to achieve those ends. Importantly, words will be placed in their appropriate context and be used in order to serve the stated objectives; as Orwell wrote in his essay 'Politics and the English Language':

> [L]et the meaning choose the word, and not the other way around.

The AB seems recently to have gotten it right in *US—Gambling*, where it stated that equating dictionary definitions to the ordinary meaning of terms is too mechanical an approach (§166).

3.2 The VCLT as a means of identifying and classifying the interpretative elements

Through interpretation, WTO adjudicating bodies also identify the interpretative elements that they have used to determine a particular issue. Let us use as an illustration the interpretation in *US—Shrimp* of the term 'exhaustible natural resources' appearing in GATT Article XX(g): recourse (by the AB) to the Convention on International Trade in Endangered Species (CITES), which provides its own definition of the term, means that a multilateral environmental agreement (MEA) could serve as an interpretative element of a term used in the WTO Agreement. The interpretation of the covered agreements becomes thus the pathway that will lead us to the identification of the interpretative elements. The second step is the classification of the interpretative elements: the VCLT contains a hierarchy of the various elements; recourse to some of them is compulsory, whereas to others, it is optional. VCLT Article 32 clearly indicates that recourse to supplementary means of interpretation will be made only in accordance with the conditions included therein and, in any event, only after recourse to VCLT Article 31 (which is compulsory) has been made and has either proved fruitless or requires confirmation. In *US—Shrimp*, the AB noted that there is a

[29] See N. David Palmeter and Petros C. Mavroidis, 'The WTO Legal System: Sources of Law' (1998) *American Journal of International Law* 92, 398–413.

hierarchy across the various elements embedded in VCLT Article 31. More specifically, the object and purpose of the treaty have an auxiliary function (§114):

> A treaty interpreter must begin with, and focus upon, the text of the particular provision to be interpreted. It is in the words constituting that provision, read in their context, that the object and purpose of the states parties to the treaty must first be sought. 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.

It follows that, every time a WTO adjudicating body refers to an interpretative element under a particular heading of VCLT Articles 31 to 32, it has *ipso facto* prejudged its legal value as well.

Practice reveals that only on occasion have WTO adjudicating bodies explicitly identified the heading under which they have examined the various interpretative elements that they have used. Take, for example, the AB report on *Korea—Dairy*, which is quite representative. It discussed a GATT-adopted report to support its interpretation of the term 'unforeseen developments'. We are left though, in the dark as to the classification of the GATT Panel report under the various headings of the VCLT (§98). The same could be said for many other reports. WTO adjudicating bodies have left no doubt with respect to some elements: the *travaux préparatoires* of the covered agreements have been consistently discussed under VCLT Article 32. The overall tendency of WTO Panels and the AB is to use various elements as 'supplementary means of interpretation', and only exceptionally classify them as 'context' or 'subsequent agreement'. Thus, they keep maximum discretion to reach their conclusions, and will use elements 'exogenous' to the WTO contract itself, only in support of conclusions that they have reached independently of the 'impact' of similar elements.

We move now to a discussion of the interpretative elements used so far in case law.

3.2.1 The text

As mentioned earlier, WTO adjudicating bodies have made extensive use of the *Oxford English Dictionary* (as well as other dictionaries) in order to interpret the WTO Agreement and its annexes.

3.2.2 The context

The Panel on *EC—Chicken Cuts* addressed a dispute between the EU and Brazil concerning the proper tariff classification of salted meat under the Harmonized System (HS) treaty (§119). To do that, the Panel first had to pronounce on the legal relevance of the HS. The HS treaty, which provides a classification for all goods traded internationally, binds several WTO members that have formally ratified it and de facto is observed by all WTO members, when scheduling their commitments: although it is not explicitly referred to in the GATT, parties routinely have recourse to it during negotiations. It has been referred to in many disputes involving tariff-classification

issues but, except for a cryptic statement by the AB in *EC—Computer Equipment* (§89) to the effect that interpretation of schedules should be in line with the HS, WTO adjudicating bodies had not clarified its status prior to *EC—Chicken Cuts*. That Panel held that the HS treaty is part of the context for the GATT (VCLT Article 31.2). Based on this conclusion, the Panel examined in detail the HS rules of interpretation.

3.2.3 Object and purpose

Various Panel and AB reports mention the GATT's preamble or its annexes as providing an authentic description of the object and purpose of the instrument that they are interpreting.

3.2.4 Subsequent agreement

The Panel on *Mexico—Telecoms* relied heavily on a series of regulations and recommendations by the International Telecommunications Union (ITU) to clarify its understanding of 'accounting rates' (§§7.129 to 7.136). In support of its decision to discuss various ITU instruments, the Panel noted that: the ITU regulations were instruments binding both Mexico and the United States; the ITU recommendations were relevant since the parties to the dispute, as well as many other WTO members, were members of the ITU. Essentially, without explicitly saying so, this Panel suggested that it was treating the ITU regulations and recommendations as something akin to subsequent agreement in the sense of VCLT Article 31.3. Irrespective of the merits of this approach, it is imperative to ask whether *Mexico—Telecoms* can be considered representative.

In *US—Clove Cigarettes* nevertheless, the AB (§§267 to 268), as already stated, considered that §5.2 of the Doha Ministerial Decision which reads:

> subject to the conditions specified in paragraph 12 of Article 2 of the Agreement on Technical Barriers to Trade, the phrase "reasonable interval" shall be understood to mean normally a period of not less than 6 months, except when this would be ineffective in fulfilling the legitimate objectives pursued

was considered to be subsequent agreement in the sense of VCLT Article 31.3(a). The AB placed emphasis on the terms used in this Decision in order to reach this finding.

3.2.5 Subsequent practice

WTO case law seems to have adopted the view that only unanimous practice by all WTO members could qualify as subsequent practice. The AB first found, in *Japan—Alcoholic Beverages II* that subsequent practice within the meaning of Article 31.3(b) entails a:

> "concordant, common and consistent" sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties [to a treaty] regarding its interpretation [at 12].

In *US—Gambling*, the AB (§192) clarified that establishing 'subsequent practice' within the meaning of Article 31(3)(b) involved two elements:

(a) there must be a common, consistent, discernible pattern of acts or pronouncements; and
(b) those acts or pronouncements must imply agreement on the interpretation of the relevant provision.

In *EC—Computer Equipment*, the AB went so far as to state that classification decisions by the HS Committee could be considered subsequent practice (§90). Then, in *EC—Chicken Cuts* the Panel held that practice by one WTO member alone can qualify as subsequent practice if it is the only relevant practice (§7.289). In the case at hand, the EU was the only importing WTO member with practice of classifying the products in question (salted chicken cuts). In light of this factual observation, the Panel accepted evidence regarding EU practice as subsequent practice in accordance with VCLT Article 31.3. On appeal, the AB half-closed the door to this understanding of the term 'subsequent practice'. It held that a few WTO members (but not only one) might establish subsequent practice, if only a few have traded in a particular commodity. The AB rejected the view, however, that reliance on practice by just one member is relevant to establishing subsequent practice in the VCLT sense of the term (§254):

> We share the Panel's view that not each and every party must have engaged in a particular practice for it to qualify as a "common" and "concordant" practice. Nevertheless, practice by some, but *not all* parties is obviously not of the same order as practice by only one, or very few parties. To our mind, it would be difficult to establish a "concordant, common and discernible pattern" on the basis of acts or pronouncements of one, or very few parties to a multilateral treaty, such as the *WTO Agreement.* We acknowledge, however, that, if only some WTO Members have actually traded or classified products under a given heading, this circumstance may reduce the availability of such "acts and pronouncements" for purposes of determining the existence of "subsequent practice" within the meaning of Article 31(3)(b). (Italics and emphasis in the original.)

Commenting on its report on *EC—Computer Equipment*, the AB further noted (§260):

> The Appellate Body made these statements in the context of an interpretation pursuant to Article 32 of the *Vienna Convention*, but, as the Panel put it, these statements "confirm[] the importance of the classification practice of the importing Member whose schedule is being interpreted [but] also indicate[] that the classification practice of other WTO Members, including the exporting Member's practice, may be relevant." In our view, these statements cannot be read to justify exclusive reliance on the importing Member's classification practice. Therefore, we fail to see how the Panel's finding that it was "reasonable to rely upon EC classification practice alone in determining whether or not there is 'subsequent practice' that 'establishes the agreement' of WTO Members within the meaning of Article 31(3)(b)" can be reconciled with these statements of the Appellate Body in *EC—Computer Equipment*. (Italics in the original.)

3.2.6 Other relevant rules of public international law

The AB in its report on *EC—Chicken Cuts* held that the HS treaty could possibly qualify as an 'other relevant rule of public international law' under VCLT Article 31.3 (c). It did classify it eventually though as legal 'context' to the GATT, as we have argued earlier (§§195 to 200).

3.2.7 Special meaning

The Panel on *Mexico—Telecoms* discussed at length (§§7.108 to 117) whether the term 'interconnection' appearing in the 'Telecoms Reference Paper' had been given a special meaning by the WTO negotiators, only to conclude that it had not. In arriving at this conclusion, however, the Panel neglected to review carefully all the relevant negotiating documents. Indeed, some of them, such as the Memorandum on Accounting Rates,[30] could have led the Panel to conclude that the term 'interconnection' was meant to cover only Mode 3, that is, cases where an investor establishes commercial presence in a foreign country and supplies services from its premises.

3.2.8 Supplementary means

Supplementary means is the most extensive category of interpretive elements classified as such by WTO adjudicating bodies. Recall that by virtue of VCLT Article 32, a judge has substantial discretion to shape the list of supplementary means:

> Recourse may be had to supplementary means of interpretation, *including* the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
> (a) leaves the meaning ambiguous or obscure; or
> (b) leads to a result which is manifestly absurd or unreasonable.

A host of heterogeneous documents have been discussed by the WTO under the heading 'supplementary means', and we will go on to discuss these.

Travaux préparatoires *of the WTO Agreement*: The term 'may' in VCLT Article 32 makes it clear that recourse to supplementary means is not a matter of legal compulsion, since the judge has substantial discretion on this score. There are many good reasons arguing against recourse. Not everyone participates in negotiations, to start with. Furthermore, the negotiating history often leads to no concrete outcome. It could also be that a provision might have acquired a whole new meaning over the years. There are also good arguments, however, in favour of recourse. Negotiations are evidence of the will of the principals (the framers) and thus help circumscribe the mandate of the agents (adjudicating bodies). Recourse to the negotiating history helps

[30] This memorandum is an understanding reached at the end of the negotiations and reflected in para. 7 of the 'Report of the Group on Basic Telecommunications', WTO Doc. S/GBT/4 of 15 February 1997. The understanding was later confirmed by the Council for Trade in Services, in para. 8 of the 'Report to the General Council on Activities During 1997', WTO Doc. S/C/5 of 28 November 1997.

to ensure that by the end of the interpretative exercise, WTO adjudicating bodies will have respected their mandate under DSU Article 3.2, that is, they will not have undone the balance of rights and obligations as struck by the framers. Since arguments can be made both in favour and against recourse to the preparatory work, the drafters of VCLT thought it sensible to leave it to adjudicating bodies to decide when such recourse should be made. What VCLT Article 32 does specify is how supplementary means are to be used: recourse to them is appropriate in order either to confirm a conclusion reached or to determine the meaning if that remains uncertain after the interpretative elements included in VCLT Article 31 have been exhausted. Obviously, it is the latter use that enhances the value and relevance of *travaux préparatoires*.

In an effort to eliminate doubts regarding the status of VCLT Article 32 in public international law, the AB held in *Japan—Alcoholic Beverages II* that there can be no doubt that VCLT Article 32, dealing with the role of supplementary means of interpretation, has attained the status of a rule of customary international law (at 97).

WTO adjudicating bodies have had recourse to VCLT Article 32:

(a) In order to confirm an interpretation reached; or
(b) In order to clarify the meaning of a term left obscure after the interpretative elements in VCLT Article 31 had been exhausted; or
(c) Very rarely, even before exhausting the elements included in VCLT Article 31.

Category (a) has known the widest use: the Panel reports on *India—Quantitative Restrictions* (§5.110), and *Canada—Pharmaceutical Patents* (§7.47) are illustrations to this effect. Recourse to preparatory work has not always led to unanimous conclusions: in *US—Upland Cotton* (§§623 to 627), the majority concluded that export credits were covered by Article 10 of the Agreement on Agriculture (AG); a minority opinion to the opposite outcome was voiced as well.[31] Category (c) is quite infrequent: in *Canada—Pharmaceutical Patents* (§7.29) the Panel, when called to interpret the term 'limited exceptions' featured in TRIPs Article 30, moved directly to the preparatory work of the TRIPs Agreement, instead of examining the term in accordance with the sequence specified in the VCLT; by the same token, in *Korea—Government Procurement* (§§7.74 to 7.83), the Panel moved directly to the negotiating history of Korea's accession to the WTO Agreement on Government Procurement in order to satisfy itself as to the actual extent of the obligations assumed by Korea. In *Canada—Dairy*, after holding that a notation in Canada's schedule of commitment was not clear on its face, the AB (§138) moved to the preparatory work in order to clarify the scope of Canada's engagement and only thereafter considered the sources identified in VCLT Article 31. In the overwhelming majority of the cases, WTO adjudicating bodies have followed the sequence established in category (b): the AB report on *US—Gambling* is an appropriate illustration (§§197 to 212).

Negotiating documents: It is common for negotiators to ask the chairman of a negotiating group to sum up in a paper the picture emerging from group discussions at a certain stage. Similar documents help reveal the extent of agreement and the extent

[31] §§631–41.

of disagreement among parties. The Panel on *US—Softwood Lumber III* was requested to provide an opinion on the legal relevance of discussion papers that were exchanged during negotiations. The Panel decided that such papers were of no probative value (§7.26). In *US—Carbon Steel* the AB clarified that the absence of probative value does not mean that such documents should be regarded as totally irrelevant. Indeed, in its view, a chairman's note could serve as indication as to what had been discussed among negotiators (§90).

Recall our discussion about the legal significance of the HS treaty. That document is not the only one that can be used in order to schedule concessions. There are other, informal agreements that are often negotiated among the trading partners that serve the same function: the 'Modalities Paper',[32] for example, reflected an agreement among negotiators during the Uruguay Round with regard to the schedules of commitments in the farm trade. The AB on two occasions dismissed the interpretative relevance of the Modalities Paper altogether: in *EC—Bananas III* the AB held that it was not explicitly referenced in the WTO Agreement on Agriculture, and, hence, was of little if any value (§117); then, in *EC—Export Subsidies on Sugar*, the AB categorically held that it did not constitute an agreement among parties (which is a point beside the point) and decided to ignore it altogether (§199). In the GATS context, informal papers have been accorded the status of supplementary means. The Panel on *Mexico—Telecoms* discussed, inter alia, the relevance of GATT/WTO Secretariat notes prepared at the request of the negotiating parties during a trade round. This Panel was examining the relevance of the 'Scheduling of Initial Commitments in Trade in Services: Explanatory Note', a document prepared by the Secretariat and later adopted by the GATS Council. The aim of the document, now widely known as the 'Scheduling Guidelines', was to help prospective WTO members with the scheduling of their commitments in the services sector. These guidelines are the equivalent for the GATS to the HS treaty for the GATT; in contrast to the HS treaty though, the Scheduling Guidelines was formally a decision of the GATS Council. The Panel decided to use the guidelines as supplementary means (§§7.43 to 7.44). This finding was echoed in *US—Gambling* (§§196 to 204); the AB paid particular attention to the fact that WTO members had based their commitments on this document. In *EC—Export Subsidies on Sugar* (§199) though, the AB noted the absence of any reference to the Modalities Paper in the WTO Agreement on Agriculture (AoA), and did not even ask whether there were schedules that had been based on this document: the mere lack of a mention in the AoA was considered adequate to determine the matter. The rationale for accepting the Scheduling Guidelines as supplementary means and rejecting the Modalities Paper is thus not the same. Form seems to be the distinguishing feature (although not explicitly relied upon by the AB): the Modalities Paper is a document prepared by the WTO Secretariat and circulated through the chairman of the negotiating group on agriculture; though it has an official document number (MTN.GNG/MA/W/24), it is not a decision by a WTO organ. By contrast, the GATS Council formally adopted the Scheduling Guidelines.

[32] Modalities for the Establishment of Specific Binding Commitments Under the Reform Programme, GATT Doc. MTN.GNG/MA/W/24 of 20 December 1993.

Informal agreements among WTO members: In *EC—Poultry*, the Panel faced the question whether, as Brazil argued, the bilateral 'Oilseeds Agreement' that it had concluded with the EU was relevant to the dispute (§202). Noting that, the Oilseeds Agreement had been negotiated within the framework of a re-negotiation of tariff commitments (GATT Article XXVIII), and citing the 'Canada/EC—Wheat' arbitration, the Panel decided to consider the Oilseeds Agreement to the extent relevant to the determination of the EU's obligations under the WTO agreements vis-à-vis Brazil. On appeal, the AB found that no reversible error in the Panel's treatment of the Oilseeds Agreement: accordingly, the AB stated that the Oilseeds Agreement could serve as a supplementary means of interpretation.

In subsequent case law, close connection between the subject matter of a bilateral agreement and the WTO Agreement emerges as the criterion for deciding whether a bilateral agreement would be taken into account by a WTO adjudicating body. A case of close connection appears in the Panel report on *EC—Poultry*; no close connection was present in *EC—Commercial Vessels*, where the Panel dealt with a bilateral agreement between Korea and the EU whereby the parties had undertaken commitments as to their shipyard sector (§§7.130 to 7.132). In the EU's view, the reason for permitting (as an exception) the subsidization of its own shipyard sector was that doing so was a response to Korea's inability to implement the bilateral agreement. The Panel did not accept this argument.

Circumstances surrounding the conclusion of the WTO Agreement: There are very few instances in which WTO adjudicating bodies have taken into account the circumstances surrounding the WTO Agreement. *Canada—Dairy* is a case in point. In this case, the AB first reached the conclusion that Canada's schedule was not clear on the issue of whether the concession entered by Canada was meant to be a continuation of past practice, as Canada had asserted, and then decided to check the negotiating history of the concession. When moving there, the AB first observed that, contrary to what had been the case with the *EC—Brazil Oilseeds* Agreement, there was no bilateral agreement between Canada and the United States (the parties in dispute). The absence of such an agreement did not, however, stop the AB from moving on to examine the circumstances surrounding the conclusion of the WTO Agreement. But instead of checking the negotiating record, the AB referred to positions taken by the parties to the dispute during the WTO Panel proceedings to substantiate its view that Canada's commitment was meant to be a continuation of past practice and not a commitment on minimum access opportunities (which would have led to important practical ramifications). In the Panel's view, non-contradicted statements made during the negotiation of the concession by the Canadian representative amounted to a tacit agreement between the parties in dispute. It is probably wise to treat this report as an outlier. The AB did not disturb the Panel's findings (§139).[33] This is the only instance where the AB accepted a tacit agreement, assuming one existed since the United States claimed that it did not, as a circumstance surrounding the negotiation of the WTO Agreement. In *EC—Computer Equipment*, the AB held that the classification practice

[33] On this issue, see Geraldo Vidigal, 'Judicial Remedies for Non-Compliance in International Law', Ph.D.Thesis, Cambridge University, 2014.

of the EU (the defendant in this case) was part of the circumstances surrounding the conclusion of the WTO Agreement (§§92 to 95). In the case at hand, the dispute between the United States and the EU concerned the latter's tariff treatment of some computer equipment.

Domestic court decisions issued at the time of negotiation: The Panel on *EC—Chicken Cuts* took the view that domestic court decisions could be regarded as supplementary means of interpretation (§7.392). In the case at hand, as discussed earlier, Brazil challenged the EU's unilateral decision to change the tariff treatment of salted chicken cuts after the WTO Agreement was concluded. In Brazil's view, the defendant's decision violated the treaty and nullified its interests since the decision subjected chicken cuts to a higher tariff regime. In defence, the EU argued, inter alia, that EU court decisions before the entry into force of the WTO Agreement made it clear that salted chicken cuts had consistently been subjected to the more burdensome of the potential tariff categories. Although it eventually rejected the EU's substantive position, the Panel accepted the relevance of similar decisions and reviewed them under the auspices of Article 32 VCLT. On appeal, the AB confirmed the Panel's understanding on this issue, adding that judgments will have less relevance than, for example, legislative acts, since they are, by definition, transaction-specific.

GATT Panel reports: Recall that Article XVI:1 of the WTO Agreement reads:

> Except as otherwise provided under this Agreement or the Multilateral Trade Agreements, the WTO shall be guided by the decisions, procedures and customary practices followed by the contracting parties to GATT 1947 and the bodies established in the framework of GATT 1947.

This clause is the institutional acknowledgement of the relevance of an (unidentified) series of GATT documents. Case law has clarified that GATT Panel reports come under the ambit of this provision. In VCLT parlance, GATT reports have been used as supplementary means. In practice, however, their importance has sometimes been more substantive than mere guidance. During the GATT years, Panel reports would not be adopted at the mere request of the winning party. Panel reports were adopted by consensus. Practice reveals that in the majority of the cases, reports were adopted through decisions by the GATT contracting parties. Some reports were never adopted, however, and their legal relevance was therefore questionable. In WTO practice, adjudicating bodies have referred not only to GATT adopted reports, but also, on occasion, to un-adopted reports, when they agreed with the legal reasoning reflected therein, in order to confirm their understanding of an issue. The question whether adopted GATT Panel reports represent 'decisions' of the contracting parties to GATT 1947, and whether they thus formed, by virtue of GATT 1994 Article 1(b)(iv), an integral part of the GATT, arose in *Japan—Alcoholic Beverages II*. The Panel held (§6.10) that adopted reports are an integral part of GATT 1994 since they are 'other decisions of the contracting parties to GATT 1947' within the meaning of GATT 1994 Article 1(b)(iv). The AB disagreed, holding that a decision to adopt a Panel report is not a decision within the meaning of this provision. In its view, adopted reports were, instead, an important part of the

GATT acquis (at 15). The term 'GATT acquis' was an invention of the AB and not detailed any further in *Japan—Alcoholic Beverages II*. The issue arose again in the Panel report on *US—FSC*. The Panel followed a different avenue this time when discussing the legal value of adopted GATT reports. In the Panel's view, decisions to adopt reports should come under Article XVI of the Agreement Establishing the WTO. On appeal, the AB followed some convoluted reasoning to end up in the same place (§115):

> We recognize that, as "decisions" within the meaning of Article XVI:1 of the *WTO Agreement*, the adopted panel reports in the *Tax Legislation Cases*, together with the 1981 Council action, could provide "guidance" to the WTO. The United States believes that the "guidance" to be drawn from the 1981 Council action, through footnote 59, is that the FSC measure is not an "export subsidy". The present dispute involves the interpretation and application of Article 3.1(a) of the *SCM Agreement* and the question of whether the FSC measure involves export subsidies *under that provision*. In contrast, the 1981 Council action addresses the interpretation and application of Article XVI:4 of the GATT 1947. The "guidance" that the 1981 Council action might provide, therefore, depends, in part, on the relationship between these different provisions. (Italics and emphasis in the original.)

As a result, it is now settled that adopted GATT Panel reports can provide useful guidance to subsequent WTO Panels dealing with the same issue and that, in practice, recourse to them can been made in order to confirm an interpretation reached through other elements of the VCLT. A representative instance is *Korea—Commercial Vessels*, where the Panel used the findings of a GATT Panel to grasp the meaning of the term 'serious prejudice' appearing in the SCM Agreement (§§7.591 to 7.602).

The Panel on *Japan—Alcoholic Beverages II* held that un-adopted reports (§6.10):

> have no legal status in either the GATT or the WTO system since they have not been endorsed through decisions by the Contracting Parties to GATT or WTO Members.

Nevertheless, practice shows that WTO Panels will still take them into account, assuming that their legal reasoning is persuasive. The Panel on *US—Lamb* looked at both adopted and un-adopted GATT reports to support one of its findings (§7.78). Likewise, the Panel on *EC—Pipe Fittings* cited an un-adopted GATT report to support its legal conclusion on a particular issue (§7.280).

WTO Panel and AB reports: WTO Panel and AB reports bind only the parties to the particular dispute and do not create binding precedent. Even so, since the AB is limited to a review of legal issues only, on many occasions its pronouncements are wider than transaction-specific. Assuming, for example, that the AB is called to pronounce on the criteria that define likeness of goods, its decision on this score will be valid for all similar transactions. Indeed, assuming the absence of distinguishing factors, the WTO membership will legitimately expect a repetition of the prior case law. WTO reports consistently contain references to prior case law: in *Japan—Alcoholic Beverages II* the AB explicitly acknowledged that case law is transaction-specific; it nevertheless noted that an equivalent provision in the ICJ Statute did not prevent the ICJ from establishing its own jurisprudence (at 13):

> It is worth noting that the Statute of the International Court of Justice has an explicit provision, Article 59, to the same effect. This has not inhibited the development by that Court (and its predecessor) of a body of case law in which considerable reliance on the value of previous decisions is readily discernible.

In *US—Shrimp (Article 21.5—Malaysia)*, the AB clarified the legal relevance of WTO Panel and AB reports. In its view, the rationale for treating adopted GATT reports as part of the GATT acquis also applied to WTO Panel and AB reports (§102):

> This reasoning applies to adopted AB Reports as well. Thus, in taking into account the reasoning in an adopted AB Report—a Report, moreover, that was directly relevant to the Panel's disposition of the issues before it—the Panel did not err. The Panel was correct in using our findings as a tool for its own reasoning. Further, we see no indication that, in doing so, the Panel limited itself merely to examining the new measure from the perspective of the recommendations and rulings of the DSB.

It seems that by the term 'acquis', the AB aims to capture the legitimate expectations by WTO members to see prior case law applied in future adjudicating experience, if relevant (that is, absent distinguishing factors across cases). This point was further clarified in *US—Line Pipe*, where the AB had the opportunity to explain that it will resort to its prior case law when, in the absence of other distinguishing features, the former and instant cases present factual similarities (§102). Yet another illustration is *EC—Sardines*, where the AB included extensive references to prior case law in order to support its position that it has the legal authority to accept *amicus curiae* briefs (§§155 to 162).

Panels have rarely deviated from prior AB rulings: one such instance is *Argentina—Preserved Peaches*, where the Panel voiced its disagreement with one of the AB's holdings (§7.24). Although legally not bound to do so, Panels will follow the AB either because they are genuinely persuaded by the reasoning or because they are aware that in case of deviation, there is little chance of eventually overturning prior case law. The Panel report on *India—Patents (EC)* eloquently captures this point (§7.30):

> Panels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same.... However,... we will take into account the conclusions and reasoning in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination we believe that we should give significant weight to both Article 3.2 of the DSU, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, and to the need to avoid inconsistent rulings (which concern has been referred to by both parties). In our view, these considerations form the basis of the requirement of the referral to the "original panel" wherever possible under Article 10.4 of the DSU. (Emphasis in the original.)

Previous GATT agreements: During the Tokyo Round, a series of agreements were signed (the so-called 'Tokyo Round codes'). Participation in those agreements was optional. Most of these agreements have been carried over into the Uruguay Round;

for example, the Uruguay Round Agreement on Antidumping (AD) succeeded the Tokyo Round AD Agreement. Importantly, however, those two agreements (as well as many others carried over from one round to the other) are not identical. At the Uruguay Round, participation to the agreements signed was not optional (with the exception of the 'plurilateral agreements'); the signed agreements were considered part of the 'single undertaking'. The Tokyo Round agreements have been consistently treated as supplementary means of interpretation: an illustration of this pattern can be seen in *Argentina—Poultry Anti-dumping Duties*, where the Panel dealt with a dispute on the consistency of Argentina's measures with the AD Agreement. In order to confirm its interpretation of Article 2, the Panel referred to the more explicit wording of the corresponding provision in the Tokyo Round AD Agreement (§7.358).

UN resolutions: The Arbitrator's report in *US—FSC (Article 22.6—US)* contains an explicit reference to the International Law Commission's report on State Responsibility, although it did not specify what its legal value was. The report, adopted as a resolution of the UN General Assembly, was intended to reflect customary international law.

OECD guidelines: The Panel on *Mexico—Telecoms* relied on the OECD guidelines to confirm its understanding of the term 'anti-competitive practice' (§7.236). In doing so, the Panel treated the OECD guidelines as supplementary means of interpretation.

Decisions by international courts: Occasionally, Panels and the AB refer to decisions by other courts as a means of supporting their own decisions. An appropriate illustration is *India—Patents (US)*, where the AB referred to the jurisprudence of the Permanent Court of International Justice (PCIJ) to support its finding that the determination of domestic law should be treated as a factual matter (§65). In doing so, the AB did not clarify the legal status of such PCIJ jurisprudence. Nevertheless, it was arguably treating the PCIJ case law as supplementary means of interpretation.

Domestic law and practice: Pursuant to the VCLT (Article 27), domestic law cannot trump WTO law (a point explicitly acknowledged in the Panel report in *Argentina—Poultry Anti-dumping Duties*, §7.108). This does not mean, however, that domestic law cannot provide a source of inspiration for WTO law, especially as a gap-filling exercise: in *EC—Tariff Preferences*, the Panel (§7.11) examined domestic codes of conduct for attorneys-at-law, such as the objectivity and independence of legal counsel, the right to consent to joint representation by the same counsel, and the equal right to discontinue such joint representation when conflicts potentially arise, on the way to deciding that such common features of professional ethical codes are equally appropriate in analysing representational conflicts of interest within the WTO dispute settlement system. The Panel, in this context, examined the Codes of Conduct of the American Bar Association, some US states, Canada, the European Union, and some EU Member States.

Doctrine: Sporadic references can be found in Panel reports to the teachings and writings of 'highly-qualified publicists', albeit rarely so. The quantity of references has picked up over the years, usually in a self-serving mood (that is, to support interpretations reached). Doctrine has always been used as supplementary means of interpretation.

3.3 Other interpretative elements

There are interpretative elements that Panels have used but have failed to classify formally. Although it seems that such elements were used as supplementary means of interpretation, their formal absence of classification requires that we classify them under 'other'. Most notably, WTO adjudicating bodies have used international treaties to interpret terms of the WTO Agreement and its annexes. In its original and its compliance reports in *US—Shrimp*, the AB referred to various regional and multilateral environmental agreements (MEAs), without classifying similar references as 'other relevant rules of public international law'. The AB's invocation of similar agreements in its original judgment led to a further dispute between the parties, and, in the compliance ruling, the AB clarified the normative significance that it attached to them in resolving the dispute between the parties: in its view, international agreements such as MEAs may not only be used as legal interpretation, but help to establish a wide agreement on certain facts (such as whether a species is endangered or whether certain resources are exhaustible), where such facts are pertinent to the application of a given legal provision. As the AB itself explained in *US—Shrimp (Article 21.5—Malaysia)*, the agreement is not thereby converted into an autonomous legal standard but is merely evidence of non-comparable, and possibly discriminatory, treatment of non-signatories (§§124, 130):

> As we stated in *United States—Shrimp*, "the protection and conservation of highly migratory species of sea turtles . . . demands concerted and cooperative efforts on the part of the many countries whose waters are traversed in the course of recurrent sea turtle migrations". Further, the "need for, and the appropriateness of, such efforts have been recognized in the WTO itself as well as in a significant number of other international instruments and declarations". For example, Principle 12 of the Rio Declaration on Environment and Development states, in part, that "[e]nvironmental measures addressing transboundary or global environmental problems should, as far as possible, be based on international consensus". Clearly, and "as far as possible", a multilateral approach is strongly preferred. Yet it is one thing to *prefer* a multilateral approach in the application of a measure that is provisionally justified under one of the subparagraphs of Article XX of the GATT 1994; it is another to require the *conclusion* of a multilateral agreement as a condition of avoiding "arbitrary or unjustifiable discrimination" under the chapeau of Article XX. We see, in this case, no such requirement.
>
> . . .
>
> At no time in *United States—Shrimp* did we refer to the Inter-American Convention as a "benchmark". The Panel might have chosen another and better word—perhaps, as suggested by Malaysia, "example". Yet it seems to us that the Panel did all that it should have done with respect to the Inter-American Convention, and did so consistently with our approach in *United States—Shrimp*. The Panel compared the efforts of the United States to negotiate the Inter-American Convention with one group of exporting WTO Members with the efforts made by the United States to negotiate a similar agreement with another group of exporting WTO Members. The Panel rightly used the Inter-American Convention as a factual reference in this exercise of

> comparison. It was all the more relevant to do so given that the Inter-American Convention was the only international agreement that the Panel could have used in such a comparison. As we read the Panel Report, it is clear to us that the Panel attached a relative value to the Inter-American Convention in making this comparison, but did not view the Inter-American Convention in any way as an absolute standard. Thus, we disagree with Malaysia's submission that the Panel raised the Inter-American Convention to the rank of a "legal standard". The mere use by the Panel of the Inter-American Convention *as a basis for a comparison* did not transform the Inter-American Convention into a "legal standard". Furthermore, although the Panel could have chosen a more appropriate word than "benchmark" to express its views, Malaysia is mistaken in equating the mere use of the word "benchmark", as it was used by the Panel, with the establishment of a legal standard. (Italics and emphasis in the original.)

The AB report on *EC—Asbestos* contains references to World Health Organization (WHO) conventions (§§124 to 135). Here, as in *US—Shrimp* cited earlier, the AB appears to have used these instruments as evidence of a wide agreement on a factual state of affairs, the toxicity of asbestos and its seriousness as a public health challenge.

4. The 'Self-Contained Regime' Problem

The analysis above suggests that WTO Panels and the AB have kept a rather reserved attitude towards the relevance of non-WTO law in the WTO legal order. It is because of this attitude that the question of whether WTO law is a 'self-contained regime' has stirred much comment.[34] The term 'self-contained regime' first came into vogue through a statement by the International Court of Justice (ICJ) in the 1980 *Hostage Case*,[35] that the rules of diplomatic law constitute a self-contained regime. Siding with other commentators, we think this remark by the ICJ was inaccurate and misleading.[36] We have also stated that commentators have distanced themselves from similar views arguing that WTO law is not a self-contained regime.[37] In this view, WTO law is a specialized system of law that governs only certain specified economic relations between states, a subset of public international law, a *lex specialis*.[38]

The real question is: to what extent may WTO dispute settlement bodies apply non-WTO rules of public international law, to wit, rules of law that cannot be found in the

[34] See, for example, Pieter Jan Kuijper, 'The Law of the GATT as a Special Field of International Law' (1994) *Neth. Y.B. Int'l L.* 227; Bruno Simma, 'Self-Contained Regimes' (1985) *Neth. Y.B. Int'l L.* 111; Anja Lindroos and Michael Mehling, 'Dispelling the Chimera of "Self-Contained Regimes": International Law and the WTO' (2005) *Eur. J. of Int'l L.* 5, 857.

[35] *Case Concerning the United States Diplomatic and Consular Staff in Tehran* [1980] ICJ Rep. 41.

[36] See Martti Koskennniemi, 'Study on the Function and Scope of the *Lex Specialis* Rule and the Question of "Self-Contained Regimes"' (2004) UN Doc. ILC(LVI)SG/FIL/CRD.1/Add.1, para. 134.

[37] Joost Pauwelyn, 'The Role of Public International Law in the WTO: How Far Can We Go?' (2001) *Am. J. Int'l L.* 95, 535, 538–9.

[38] Examples of these three categories of rules abound. For example, the right to levy tariffs or charges on imports confirms the general public international law rule; the national treatment rule of GATT Art. III is a new rule unknown to public international law; and the DSU rules on suspension of concessions derogate from the general international law rules on countermeasures.

'covered agreements'?[39] We agree with Pauwelyn that 'the fact that the substantive jurisdiction of WTO panels is limited to claims under WTO covered agreements does not mean that the applicable law available to a WTO panel is necessarily limited to WTO covered agreements.'[40]

What else then? The discussion so far suggests that very little else has been introduced into the WTO legal order by WTO Panels and the AB, and in the overwhelming majority of cases, any such introduction has been done simply in order to support interpretations that Panels and the AB had already reached. Non-WTO law thus, has been used sparingly in WTO adjudication, and when it has been, its purpose is to support outcomes that could have been reached irrespective of whether recourse to it had ever been made.

Is this shocking? In a previous study,[41] we examined the relationship between WTO law and multilateral environmental agreements (MEAs) in WTO dispute settlement. We sought to address this relationship in light of the reason why the parties had chosen to separate their obligations into two bodies of law without providing for an explicit nexus between them. The cautious WTO attitude towards MEAs had been heavily criticized in literature. We adopted a different approach. In our view, the legislators' silence concerning the relationship between the two bodies of law should speak volumes. MEAs might be a precious source of information, but should not be automatically understood as imposing legally binding obligations on the WTO membership. They could, and indeed should, be used as sources of factual information. To explain this further:

Assume that Home and Foreign, two WTO members have signed an MEA between them. Assume that they enter into a WTO dispute, which overlaps (in terms of subject matter) with the MEA. The WTO judge cannot immediately adjudicate using the MEA as the reflection of the members' reciprocal commitments, irrespective of formal grounds (for example, that the MEA is not a covered agreement). First, the judge cannot assume that Home and Foreign wanted their disputes under the MEA adjudicated before a WTO Panel. Second, there is no guarantee at all that whatever decision a judge might reach in a dispute between Home and Foreign will have any impact in future disputes between WTO members that have nothing to do with the MEA. After all, the judge will be adjudicating a dispute under GATT Articles III and XX in both instances. Digressing into the balance of obligations established through the MEA in order to understand the legal ambit of GATT provisions is a dangerous path, all the more so when the WTO judge has no mandate to this effect.

A similar attitude is recommended in general when WTO judges are faced with questions regarding the relevance of non-WTO law. In the absence of a mandate, the judge is well advised to use non-WTO law as a valuable source of factual information, and to avoid prejudging the balance of rights and obligations as struck by the framers of the WTO. The judge is the agent after all, not the principal, as we have noted earlier.

[39] See Pauwelyn, 'The Role of Public International Law in the WTO', n. 37.

[40] Ibid. 560.

[41] Henrik Horn and Petros C. Mavroidis, 'Multilateral Environmental Agreements in the WTO: Silence Speaks Volumes' (2014) *International Journal of Economic Theory* 10, 147–65.

Under the circumstances, the overall attitude of WTO judges to treat non-WTO law overwhelmingly as 'supplementary means of interpretation' is to be commended.

5. Concluding Remarks

It is for the WTO members to draw up the list of sources of law. Because of the very demanding requirements associated with the process of adopting interpretations/ amendments of the covered agreements, the interpretation of WTO law de facto falls most often to WTO dispute settlement bodies. The mandate that the members gave to the WTO judge was to interpret the WTO contract, without undoing the agreed balance of rights and obligations (DSU Article 3.2). The legislative guidance (to have recourse to customary rules of interpretation, when interpreting the WTO contract), has been understood by the WTO judge as an implicit reference to the VCLT. Nothing shocking here, since the VCLT was, in this respect, codification of customary law. The judge is thus an agent with a mandate to use the VCLT in a manner that does not undo the will of the principals.

The task of the judge is arduous, since the VCLT is an incomplete contract: first, the VCLT does not explicitly refer to the precise weight that should be given to each one of its interpretative elements, and second, the boundaries among the various elements mentioned in the VCLT are not always clear-cut, with the consequence that the classification exercise itself will affect outcomes. The WTO judge has some discretion in classifying the various interpretative elements, as their legal significance will depend on the outcome of the classification exercise.

The survey of WTO practice on interpretation of WTO law leads us to conclude that the WTO judge has used the VCLT in a compartmentalized manner, that is, the conclusion about the interpretation of a certain term will, in the overwhelming majority of cases, be reached when examining the ordinary meaning of the terms and will merely be confirmed through recourse to other VCLT elements. The direct consequence of this approach is that there will be no need to look actively for contextual elements, or supplementary means, since the conclusion has been already reached, and all interpretative elements will merely support a fait accompli. Furthermore, the WTO judge has classified, when in doubt, sources under supplementary means of interpretation and thus reduced their legal significance.

4

Dispute Settlement

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1. Introduction

One of the strengths of the WTO is the dispute settlement system, which came into operation on 1 January 1995. This system has rapidly become the most important international tribunal. The WTO dispute settlement institutions function very much like a court of international trade: there is compulsory jurisdiction, disputes are settled largely by applying rules of law, decisions are binding on the parties, and sanctions may be imposed if decisions are not observed.

From its inception, the WTO dispute settlement mechanism has been very busy; more than eighty cases were filed in the first two years, and more than 400 cases had been filed at the time of writing. This activity implies confidence in the system and places political pressure on all states to comply, because many, including the most important trading nations, are both complainants and respondents in the various trade disputes considered.[1]

[1] For an excellent detailed treatment of the subject, see Ernst-Ulrich Petersmann, *The GATT–WTO Dispute Settlement Mechanism, International Law, International Organizations and Dispute Settlemen*t (Kluwer Law International, 1997). For a practical handbook, see N. David Palmeter and Petros C. Mavroidis, *Dispute Settlement in the World Trade Organization* (Cambridge University Press, 1999). For suggestions and evaluations, see 'Symposium on The First Three Years of the WTO Dispute Settlement System' (1998) *Nr' l Law* 32l, 609 (1998). For a recent evaluation of dispute settlement at the WTO, see The World Trade Organization, *The Future of the WTO, Addressing Institutional Challenges in the New Millennium* (*The Sutherland Report)* (WTO, 2004) Chapter VI, 49–59.

2. Dispute Settlement in the GATT

The WTO dispute settlement system is the result of over forty years of experience and the evolution of dispute settlement under the GATT 1947. The WTO system can be appreciated only against the background of the GATT regime.

The GATT avoids mention of the term 'dispute'. The drafters of the GATT did, however, foresee that problems would arise due to future actions or non-actions of one or more GATT contracting parties concerning the matters covered in the GATT. The principal mechanism for dealing with these problems is diplomatic consultation. There are nineteen provisions for consultation in the GATT 1947.[2] One of these, Article XXII, is a general provision calling for 'sympathetic consideration' and consultation 'with respect to any matter affecting the operation of this Agreement'.[3]

GATT Article XXIII creates a specific mechanism to correct 'nullification or impairment' of the GATT. Nullification or impairment can occur for any one of three reasons: (1) failure of a party to carry out its obligations under the GATT; (2) the application of a measure by a party regardless of whether the measure conflicts with the GATT; or (3) the existence of any other 'situation' that is troublesome.[4] Thus, dispute settlement addresses more than just breaches of the GATT.

Article XXIII specifies a series of steps for dealing with a possible nullification or impairment. Each step is an escalation to be taken if previous attempts to settle the matter are ineffective:

1. The party concerned addresses 'written representations or proposals' to the other contracting party or parties, which must give these representations or proposals 'sympathetic consideration'.[5]
2. The matter may be referred to the contracting parties, which 'shall promptly investigate' and make appropriate recommendations to the parties concerned.[6] Alternatively, this may take the form of a 'ruling on the matter'. In the course of the investigation, the contracting parties may consult with contracting parties, 'any appropriate inter-governmental organization', or the UN Economic and Social Council.[7]
3. The contracting parties may authorize a contracting party or parties to suspend the application of concessions or obligations under the GATT as a countermeasure if 'the circumstances are serious enough'.[8] The party against which this action is directed may then withdraw from the GATT on sixty days' notice.[9]

Article XXIII and dispute settlement under the GATT 1947 were shaped by state practice. At first, diplomatic negotiations were the sole means of dealing with controversies. Then, 'working parties' began to be established to investigate and formulate recommendations. Working parties were typically composed of representatives of various countries who received instructions from their governments. In 1955, the GATT contracting parties began referring disputes to 'Panels', ad hoc groups of experts

[2] John H. Jackson, *World Trade and the Law of GATT* (Bobbs-Merrill Co., Inc., 1969) § 8.2 at 164.
[3] GATT Art. XXII:1. [4] GATT Art. XXIII:1(a)–(c). [5] GATT Art. XXIII:1.
[6] GATT Art. XXIII:2. [7] Ibid. [8] Ibid. [9] Ibid.

who acted as neutrals, not government representatives. Panel decisions had no official or binding effect but were referred to the GATT Council,[10] which could make the 'appropriate recommendations'.[11]

The GATT Panel decision process of dispute resolution was successful. Because it was frequently utilized, it became necessary to formalize the Panel procedures. This led to a series of agreements and understandings on dispute settlement[12] to supplement the skeleton approach of Article XXIII. Over the years, panels began to take a more rule-oriented, judicial approach to settling disputes. Parties invoked Article XXIII to vindicate their legal rights under the GATT. The panels' recommendations rested on legal, rather than merely diplomatic, grounds. To a remarkable degree, the decisions of the GATT panels adopted by the GATT Council were implemented and observed by states. This was not due to the threat of suspension of concessions,[13] but rather was an accomplishment of the dynamics of the process. A losing party could not ignore a decision based on legal principles. To do so would threaten the entire legal order on which the GATT system was based and which the losing party would need (and might be on the winning side of) in other cases.

Despite the success of the GATT Panel dispute resolution process, serious shortcomings inhibited its effectiveness. Such shortcomings included delays in the formation of Panels and the Panel process, blocking of the adoption of Panel reports in the GATT Council, and delays in the implementation of Council recommendations. The Tokyo Round of multilateral trade negotiations added dispute resolution procedures to

[10] The GATT Council, which was set up by resolution of the contracting parties in 1960, 'consisted of representatives of all GATT contracting parties who wished to assume the responsibility of such membership', and met almost monthly. John H. Jackson, *The World Trading System*, 2nd edn. (Bobbs-Merill Co., Inc., 1997) 63.

[11] For detailed treatment of this history, see especially Ernst-Ulrich Petersmann, 'The Dispute Settlement System of the World Trade Organization and the Evolution of the GATT since 1948' (1994) *Common Mkt. L. Rev.* 31, 1157; Robert E. Hudec, *Enforcing International Trade Law: The Evolution of the Modern GATT Legal System* (Butterworth Legal Publications, 1993) 9.

[12] These are as follows: (1) The 1966 Decision on Procedures under Article XXIII, 5 April 1966, GATT B.I.S.D. (14th Supp) at 18 (1966) (applying to disputes between a developing country contracting party and a developed country contracting party); (2) Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance, 28 November 1979, GATT B.I.S.D. (26th Supp) at 210 (1979); (3) The 1982 Decision on Dispute Settlement Procedures, 29 November 1982, GATT B.I.S.D. (29th Supp) at 9, 13–16 (1983); (4) here refer to the Decision on Dispute Settlement Procedures, 30 November 1984, GATT B.I.S.D. (31st Supp) at 9–10 (1984); and (5) The 1989 Decision on Improvements to the GATT Dispute Settlement Rules and Procedures, 12 April 1989, GATT B.I.S.D. (36th Supp) at 61 (1989).

[13] The suspension of concessions was authorized in only one case under the GATT. This case involved import restrictions on dairy products maintained by the United States. After a GATT Working Party found that these restrictions were inconsistent with the GATT, the contracting parties authorized the Netherlands to suspend concessions so that the importation of wheat flour would be limited to 60,000 metric tons in 1953. Netherlands Measures of Suspension of Obligations to the United States, 8 November 1952, GATT B.I.S.D. (1st Supp) at 33 (1952). Both the Netherlands and the United States abstained from voting on this authorization. The Netherlands never acted to implement this suspension, presumably because it would have been ineffective. See Robert E. Hudec, 'Retaliation Against Unreasonable Foreign Trade Practices' (1975) *Minn. L. Rev.* 59, 461, 505–7.

the various Codes approved in 1979. The result was dispute resolution procedures that were confusing in number and were largely uncoordinated.[14]

These difficulties were addressed in the new system of dispute settlement adopted by the WTO.

3. WTO Dispute Settlement

In the negotiations leading to the establishment of the WTO dispute settlement mechanism, the debate focused on whether a negotiation approach would be superior to a more legalistic, rule-oriented approach.[15] Fears were expressed that reforms which gave primacy to legal rules would impair the WTO's credibility because powerful states would inevitably ignore the rules when they went against their national interests.[16] However, the evolution of the WTO dispute settlement system over a period of almost twenty years has disproved the misgivings entertained by some members and the judicialized, rule-oriented approach to dispute resolution has prevailed at the WTO.

3.1 General considerations

The WTO dispute settlement system is built on the pre-existing GATT regime. The document establishing the new system is the Uruguay Round Understanding on Rules and Procedures Governing the Settlement of Disputes (Dispute Settlement Understanding or DSU). DSU Article 3.1 affirms the application of GATT 1947 Articles XXII and XXIII. In addition, the WTO Agreement provides that '[e]xcept as otherwise provided under this Agreement or the Multilateral Trade Agreements, the WTO shall be guided by the decisions, procedures and customary practices followed by the Contracting Parties to GATT 1947'.[17]

3.2 Institutions

Three institutions administer the WTO dispute settlement system. The first institution is the Dispute Settlement Body (DSB), which establishes Panels, adopts Panel and Appellate Body reports, supervises the implementation of recommendations and rulings, and authorizes sanctions for failure to comply with dispute settlement decisions.[18] The General Council of the WTO serves as the DSB, but the DSB has its own chairman and follows separate procedures from those of the General Council.[19]

[14] See Amelia Porges, 'The New Dispute Settlement: From the GATT to the WTO' (1995) *Leiden J. Int'l L.* 8, 115; Norio Komuro, 'The WTO Dispute Settlement Mechanism: Coverage and Procedures of the WTO Understanding' (1995) *J. World Trade*, 29(4), 5, 17–37; John P. Gaffney, 'Due Process in the World Trade Organization: The Need for Procedural justice in the Dispute Settlement System' (1999) *Am.U. Int'l L. Rev.* 14, 1173.

[15] Jackson, *The World Trading System*, n. 10 at 85–8.

[16] Hudec, *Enforcing International Trade Law*, n. 11 at 362–6; Edwin Vermulst and Bart Driessen, 'An Overview of the WTO Dispute Settlement System and Its Relationship with the Uruguay Round Agreements: Nice on Paper but Too Much Stress for the System?' (1995) *J. World Trade* 29(2), 131, 146.

[17] WTO Agreement Art. XVI:1. [18] DSU Art. 2.1. [19] WTO Agreement Art. IV:3.

The DSU creates an Appellate Body to review Panel rulings.[20] The Appellate Body is a standing institution composed of seven persons appointed by the DSB for four-year terms.[21] The members of the Appellate Body must be persons with demonstrated expertise in law and international trade who are not affiliated with any government. The Appellate Body membership must be 'broadly representative of membership in the WTO'.[22] The Appellate Body members hear cases in divisions of three, but each member is required to 'stay abreast' of the dispute settlement activities of the WTO.[23]

The WTO system continues the Panel system of the GATT 1947. Panels are composed of three (exceptionally five) persons, 'well qualified governmental and/or non-governmental individuals', selected from a roster of persons suggested by WTO members.[24] Panel members serve in their individual capacities and not as representatives of WTO members.[25]

3.3 Scope of application

The competence of the WTO Dispute Settlement Body is set out in DSU Article 1. Any dispute arising out of any of the multilateral WTO agreements must be resolved according to the rules and procedures of the DSU.[26] These agreements, which are referred to collectively as the 'covered agreements', are listed in DSU Appendix 1.[27] Some WTO agreements contain special or additional rules and procedures, and the DSU incorporates these rules and procedures as well.[28] In the event of conflict, the special or additional rules and procedures prevail.[29]

In its interpretation of the covered agreements, Panels and the Appellate Body are guided by 'customary rules of interpretation of public international law',[30] a reference to the Vienna Convention on the Law of Treaties (VCLT).[31] Interpretations of the WTO agreements by Panels and the Appellate Body are not, however, definitive. Only the Ministerial Conference and the General Council have the authority to adopt definitive interpretations.[32]

An interesting and unresolved issue is whether WTO Panels and the Appellate Body have jurisdiction to decide questions of public or private international law (or even

[20] DSU Art. 17. [21] DSU Art. 17.1 and 17.2. [22] DSU Art. 17.3.

[23] DSU Art. 17.1. Art. 4 of the Working Procedure drafted by the Appellate Body (Working Procedures for Appellate Review, Dated 28 February 1997 (WT/AB/WP/3)) provides for 'collegiality' of members of the Appellate Body. Members must convene on a regular basis to discuss matters of policy, practice, and procedure, and shall stay abreast of dispute settlement activities and other relevant activities of the WTO. In particular, each member shall receive all documents filed in an appeal. The Working Procedure also provides for an 'exchange of views' by stating that 'the division responsible for deciding each appeal shall exchange views with the other Members before the division finalizes the appellate report for circulation of the WTO Members.' When a division handling a dispute has finished an oral hearing, the other three members join the three members of the division and hold an exchange of views. In this way, members of the Appellate Body who are not members of the division handling the dispute can keep abreast of what is happening in the case and give their views on the matter. This is a device to ensure consistency of Appellate Body rulings through collegiality of members.

[24] DSU Art. 8.4, 8.5, and 8.6. [25] DSU Art. 8.9. [26] DSU Art. 1.1.

[27] Ibid. [28] DSU Art. 1.2. [29] Ibid. [30] DSU Art. 3.2.

[31] Vienna Convention on the Law of Treaties, available at <http://www.un.org/law/ilc/texts/treatfra.htm>.

[32] WTO Agreement Art. IX:2.

Member State law) when such issues arise in connection with a controversy under a covered agreement. An example is the dispute brought by the European Community (EC) before the WTO concerning the US Helms-Burton law's provision imposing economic sanctions on persons and companies that own certain property in Cuba.[33] This dispute concerned provisions of a 'covered agreement', GATT (Article XXI), as well as questions of public international law regarding extraterritorial jurisdiction and the doctrine of non-intervention. At the EC's request, this dispute was suspended when the United States waived application of key provisions of the disputed law. If there is conflict between a provision in a covered agreement and a rule in other international agreement or the customary international law, Panels and the Appellate Body must adhere to the provision in the covered agreement and reject any rule that is in conflict with it. This seems clear from DSU Article 3.2 which states that 'Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreement.'[34] However, as long as rights and obligations of members provided in the covered agreements are not affected, there is nothing in the covered agreement or the DSU which prohibits Panels and the Appellate Body from applying rules incorporated in other international agreements or the customary international law.[35] However, one may argue that an application of any rules other than those contained in the covered agreement is inherently outside the power of Panels and the Appellate Body.

On the other hand, one may argue that to avoid a piecemeal decision that does not resolve the dispute, it is advisable that the WTO institutions have competence to consider all aspects of a dispute, including those involving legal issues not strictly arising under a covered agreement. DSU Article 11 arguably provides this authority by granting to Panels the authority to 'make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements'. In addition, the Vienna Convention Article 31.2(c), provides for the application of 'any relevant rules of international law applicable in the relations between the parties', in connection with the interpretation of a treaty. Because the DSU incorporates this interpretive principle,[36] Panels and the Appellate Body should be able to apply such rules where relevant.[37] Alternatively, a legal question involving public international law could be the subject of a request by the WTO for an Advisory Opinion from the International Court of Justice (ICJ).[38] The Advisory Opinion

[33] *US—The Cuban Liberty and Democratic Solidarity Act*, WT/DS38 (suspended at the request of the EC, the complaining member).

[34] For more extensive discussion, see Chapter 3, sections 4 and 5 of this book.

[35] See generally Joost Pauwelyn, 'The Application of Non-WTO Rules of International Law in WTO Dispute Settlement' in Patrick F. J. Macrory, Arthur E. Appleton, and Michael G. Plummer, eds., *The World Trade Organization: Legal, Economic and Political Analysis* (Springer, 2005) 1406–25.

[36] DSU Art. 3.2.

[37] Therefore, the WTO/GATT is not a self-contained legal regime. See P. J. Kuyper, 'The Law of GATT as a Special Field of International Law: Ignorance, Further Refinement or Self-Contained System of International Law' (1994) *Neth. Y.B. Int'l L.* 25, 227, 229–32. For an argument that WTO panels have broad authority to decide all relevant questions of public international law, see Joost Pauwelyn, 'The Role of Public International Law in the WTO: How Far Can We Go?' (2001) *Jam. J. Int'l L.* 95, 535, 554–9.

[38] Statute of the International Court of Justice, 26 June 1945, Arts. 65–8, 59 Stat. 1055, T.S. No. 993 (1945), available at <http://www.icj-cij.org/icjwww/ibasicdocuments/ibasictext/ibasicsta-tute.htm>.

procedure, however, would appear to be impractical and time-consuming because the DSB and the General Council would have to agree to make the request and the matter would have to be argued and decided separately by the ICJ.

3.4 The legal effect of Panel and Appellate Body reports

WTO Panel and Appellate Body reports are binding on the parties to the dispute once the DSB adopts them.[39] They are not binding interpretations of the WTO agreements, however, and have no legal effect on other WTO members. They also are not precedents that are legally binding in subsequent cases. Nevertheless, such reports constitute evidence of treaty practice, and subsequent dispute settlement Panels and the Appellate Body rely on their reasoning. To the extent their reasoning is persuasive, even unadopted reports may be cited and relied on by subsequent Panels.[40] In fact, Panels and the Appellate Body closely examine precedents when dealing with a dispute and try not to deviate from the interpretations established by the precedents.

Although there is no *stare decisis* in the WTO jurisprudence in a strict sense of the term, it is generally considered that the failure of Panels to follow precedents (especially holdings of the Appellate Body) undermines the development of a coherent and predictable body of jurisprudence clarifying members' rights and obligations under the covered agreements. In fact, Panels are most careful not to deviate from the rules established in previous appellate reports and, in this respect, rules enunciated in previous appellate reports have operated as the authority for subsequent Panels and appellate reports.[41]

Panels issue findings of fact and law in dispute cases and the Appellate Body reviews Panels' interpretation of WTO agreements. Judging from this hierarchical structure of the dispute settlement process, one might argue that Panels are obligated to follow previous appellate reports if they deal with the same subject matter.[42]

Panels and the Appellate Body are guided by the rules of interpretation of treaties contained in the Vienna Convention. Articles 31 and 32 of the Vienna Convention are especially relevant. Article 31 states, 'A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.' Article 32 states, '1. Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning

[39] They are not precedents that are legally binding in subsequent cases. Nevertheless, such reports constitute evidence of treaty practice, and subsequent dispute settlement Panels and the Appellate Body are free to cite them and rely on their reasoning. To the extent their reasoning is persuasive, even unadopted reports may be cited and relied on by subsequent panels. In fact, Panels and the Appellate Body closely examine precedents when dealing with a dispute and try not to deviate from the interpretations established by the precedents. 'Appraisal and Prospects' in Anne O. Krueger, ed., *The WTO as an International Organization* (Chicago University Press, 1988) 161, 169–70.

[40] This has been authoritatively stated. See *Japan—Alcoholic Beverages*, Appellate Body report, Part E, para. 8.

[41] *US—Shrimp (Viet Nam)*, Panel report, para. 7.141.

[42] *US—Continued Zeroing*, WT/DS350/AB/R, adopted 19 February 2009.

resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.'

In almost every report of Panels and the Appellate Body, Article 31 of the Vienna Convention is cited and dictionary meanings of the relevant words in the provision in question are discussed. Although Article 32 is used rarely, there are cases in which the Appellate Body relied on Article 32, as exemplified by the *Canada—Dairy* case.[43]

3.5 Dispute resolution procedures

3.5.1 Objectives

As under the GATT, the WTO dispute settlement system is based on the central idea that the rights and obligations of the members under the WTO agreements are to be preserved and safeguarded.[44] To that end, the prompt settlement of 'situations' in which a member considers its rights to be impaired is 'essential to the effective functioning of the WTO'.[45] Thus, the objective of WTO dispute settlement is to secure the withdrawal of any measure that is found to be inconsistent with any agreement or to foster a mutually acceptable solution that is consistent with the WTO agreements.[46] All settlements and solutions must be consistent with the covered agreements.[47]

3.5.2 Initiation: request for consultations

The DSU cautions WTO members to be judicious about invoking the dispute settlement procedures. They should consider whether the action 'would be fruitful' and would 'secure a positive resolution to a dispute'.[48] The first step is to make a request for consultations with the other member or members. Only after this consultation do the parties have a right to invoke the Panel process.

Upon a request for consultations, the member concerned must reply within ten days and must enter into good faith consultations within thirty days after receiving the request.[49]

3.5.3 Standing to bring claims

A WTO Panel and the Appellate Body, in *EC—Bananas*, addressed the matter of standing to pursue a claim. In that case, the European Communities questioned the 'legal interest' of the United States to bring a dispute involving bananas because US banana production was minimal and the United States did not export bananas. The Appellate Body concluded that a WTO member has broad discretion in deciding to bring a case under the DSU:

[43] *Canada—Dairy*, Appellate Body report, WT/DS 103, 113/AB/R, 27 October 1999, paras. 138–42.
[44] DSU Art. 3.2. [45] DSU Art. 3.3. [46] DSU Art. 3.7. [47] DSU Arts. 3.5 and 3.6.
[48] DSU Art. 3.7. [49] DSU Art. 4.3.

> The wording of Article XXIII:1 of the GATT 1994 and of Article 3.7 of the DSU suggests, furthermore, that a Member is expected to be largely self-regulating in deciding whether any such action would be "fruitful". We are satisfied that the United States is a producer of bananas, and a potential export interest by the United States cannot be excluded. The internal market of the United States for bananas could be affected by the EC banana regime, by the effects of that regime on world supplies and world prices of bananas.
>
> We agree with the panel report that "neither Article 3.3 nor 3.7 of the DSU nor any other provision of the DSU contains any explicit requirement that a Member must have a 'legal interest' as a prerequisite for requesting a panel". We do not accept that the need for a legal interest is implied in the DSU or in any other provision of the WTO Agreement.[50]

This is, in effect, the recognition of an '*actio popularis*' because all WTO members would seem to have an interest in any material breach of the covered agreements. The liberal approach to standing is quite new and controversial; there was no tradition of such complaints under the GATT.[51]

In addition, any WTO member that is not a party to the original dispute may intervene in one of two ways. First, such a member 'having a substantial interest in a matter before a panel' has an opportunity to be heard both orally and in writing.[52] Second, such a 'third party' to a dispute may freely bring an original complaint under the normal dispute settlement procedures.[53] Whenever 'feasible', a single Panel will handle both (or all) complaints related to the original matter.[54]

3.5.4 Good offices, conciliation, and mediation

The DSU provides that the parties to a dispute may agree 'voluntarily' to employ good offices, conciliation, or mediation as a settlement technique.[55] Such procedures may begin or be terminated at any time.[56] An agreement to use these procedures, however, does not preclude the establishment of a dispute settlement Panel. The complaining party must allow a period of sixty days after the date of the request for consultations before requesting the establishment of a Panel. If the parties agree, procedures for good offices, conciliation, or mediation may proceed even after a Panel has been established.[57]

[50] DSU Art. 10.2.

[51] GATT Art. XXIII:1 states 'If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of [failure of another contracting party to comply with its obligations under this Agreement], *the contracting party* may . . . make written representations or proposals to the other contracting party . . . ' (emphasis supplied). Art. XXIII:2 goes on to provide that if no satisfactory solution is achieved, the matter may be referred to the contracting parties for investigation. These provisions seem to suggest that a contracting party can bring a case with regard to a measure of another contracting party to the WTO for a systemic reason even if there is no immediate nullification and impairment caused by it. In other words, a party can bring a case before the WTO DSB with regard to a measure of another party in order to maintain the soundness of the WTO system even if there is no immediate trade effect on the claiming party.

[52] DSU Art. 10.4. [53] DSU Art. 9.1. [54] DSU Art. 5. [55] Ibid.

[56] Ibid. [57] DSU Art. 5.6.

Normally, the WTO Director-General, acting in an ex officio capacity, will offer good offices, conciliation, or mediation.[58] These three procedures are similar in that a neutral third party is involved to aid the process of dispute settlement. A good officer is more of a channel of communication than an active participant in the dispute settlement process. A conciliator independently investigates the dispute and makes a written proposal for its resolution. A mediator is an active participant in the dispute settlement process, bringing the parties together in an informal setting and making suggestions for resolution and closure of the dispute. In practice, the three procedures tend to blend. These procedures are useful not only in resolving issues of law and fact but also in dealing with non-justiciable issues that an adjudicative process cannot settle.

3.5.5 Arbitration

WTO members can agree to use binding arbitration as an alternative means of dispute settlement.[59] In such a case, the parties to the dispute can define the issues and the procedures to be followed. Any arbitration award is then enforceable through the WTO. DSB and WTO sanctions may be imposed for non-compliance.

3.6 The Panel process

If consultations fail to settle the dispute within sixty days (twenty days 'in cases of urgency'), the complaining party may request the establishment of a Panel.[60] A Panel *must* be established at the next DSB meeting unless it is decided by consensus not to establish a Panel.[61] Unless the parties to the dispute agree otherwise Panels are composed of three (exceptionally five) qualified governmental or non-governmental individuals chosen from lists maintained by the Secretariat. The parties to a dispute have twenty days to agree on the panellists; if they fail to agree, panellists are appointed by the Director-General. Citizens of the states that are parties to the dispute (including citizens of the same customs union or common market) cannot serve as panellists.[62] Unless the parties to the dispute agree otherwise, the parties to the dispute also have twenty days from the establishment of the Panel to agree on the 'terms of reference' of the Panel; otherwise, standard terms of reference will be used.[63]

DSU Article 6:2 provides: 'The request for the establishement of a panel shall... identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.' Therefore, the terms of reference in a given dispute must identify the specific measures at issue and set out a brief summary of the legal basis of the complaint. The terms of reference can be called 'claims' which set out the scope of the dispute. Once the terms of reference are adopted with respect to a dispute, they cannot be changed through the entire process of the

[58] DSU Art. 25. [59] DSU Art. 4.7 and 4.8.
[60] DSU Art. 6.1. [61] DSU Art. 8.3.
[62] DSU Art. 7.1. The 'negative consensus' process of decision making is a key innovation of the DSU.
[63] DSU Art. 9.1.

dispute settlement although the parties can amplify the claim without changing the nature of the claim.[64]

In *China—Minerals*, the respondent (China) argued that the claimants (the United States, the European Union (EU), and Mexico) did not lay out specifics of their claims and therefore infringed DSU Article 6.2. The Panel held that, although specifics were somewhat unclear in the original terms of reference, later submissions of the respondents explained the details and consequently there was no infringement of DSU Article 6.2.[65] China appealed and the Appellate Body reversed the finding of the Panel, stating that defects in the terms of reference could not be cured by later submissions because this would prejudice the right of defence of the respondent.[66] However, this ruling of the Appellate Body may be too rigid and deprive the dispute settlement process of the WTO of flexibility.[67]

Frequently, more than one member requests the establishment of a Panel, and the interests of more than two parties are involved in a dispute. In such cases, a single Panel can consider the disputes of multiple complainants,[68] and third parties that have an interest in a dispute have the right to be heard by the Panel.[69]

A Panel's function is to assist the DSB in resolving the dispute.[70] The Panel operates on a timetable that, generally, shall not exceed six months (three months in cases of urgency).[71] The Panel process involves the following: (1) written submissions of parties and third parties; and (2) meetings (oral hearings) with parties and third parties.[72]

The Panel may seek information and technical advice from any appropriate source.[73] The Panel also is given a wide discretion to select which evidence it accepts and which it does not.[74] In addition, the Panel may request an advisory report in writing from an Expert Review Group.[75] The Panel then submits a draft report to the parties to the dispute. After comments by the parties, the Panel prepares an interim report consisting of findings of fact, and conclusions of law. The interim report is circulated to the parties, which can request a meeting with the Panel to discuss the issues. At the conclusion of this interim review process, the panel prepares a final report and transmits it to the DSB.[76]

[64] For a discussion of the terms of reference, see *Australia—Apples*, WT/DSD367/AB/R, adopted 17 December 2010.

[65] *China—Raw Materials*, Panel report, WT/DSD394/R, WT/DSD395/R, WT/DS398/AB/R, 5 July 2011, para. 7.3(b).

[66] *China—Raw Materials*, WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R, 30 January 2012, para. 234.

[67] For comments and criticisms of the report of the Appellate Body, see Mitsuo Matsushita, 'A Note on the Appellate Body Report in the Chinese Minerals Export Restrictions Case' (Winter 2012) *Trade, Law and Development* IV(2), 400 *et seq.*

[68] DSU Art. 10.2.

[69] DSU Art. 11. The Working Procedures for Panels are set out in DSU Appendix 3.

[70] DSU Art. 12.8. [71] DSU Art. 12. [72] DSU Art. 13.1.

[73] DSU Art. 13.2. The rules and procedures governing Expert Review Groups (ERGs) are set out in DSU Appendix 4. Their function is to make available technical and scientific expertise to Panel members. ERGs work under the authority of the Panels, which decide their terms of reference and their working procedures. DSU Appendix 4, para. 1. Their initial reports are advisory only. DSU Appendix 4, para. 6.

[74] *US—Tuna II (Mexico)*, WT/DS381/AB/R, adopted 13 June 2012, paras. 256–72.

[75] DSU Art. 15. The deliberations of the Panels are confidential. DSU Art. 14.

[76] DSU Art. 16.1.

The DSB has twenty days to consider the report after it has been circulated to members.[77] Objections to the report must be made at least ten days before the DSB is to meet.[78] Within sixty days after the submission of the report, the DSB must adopt it unless there is a consensus against adoption.[79] If a party has notified its decision to appeal, the DSB may not consider the report until after the completion of the appeal.[80]

3.7 The appellate process

Any party to a dispute (but not third parties) may appeal a Panel report to a seven-member standing Appellate Body established for this purpose.[81] The Appellate Body sits in divisions of three members.[82] Appellate Body members are appointed for four-year terms and cannot be affiliated with any government.[83] The Appellate Body has the power to uphold, modify, or reverse the legal interpretations adopted by the Panel.[84] Generally, the appellate process must be completed within sixty days but shall in no case exceed ninety days.[85] Within thirty days following the circulation of an Appellate Body report, the report must be adopted by the DSB and 'unconditionally accepted by the parties to the dispute' unless the DSB decides by consensus not to adopt the report.[86]

3.8 Implementation

The losing party must inform the DSB of its intentions 'in respect of implementation of the recommendations and rulings of the DSB' within thirty days of the date of the adoption of a Panel or Appellate Body report.[87]

3.8.1 Reasonable period for implementation

Losing parties have an obligation to comply with the recommendations and rulings of the DSB within 'a reasonable period of time'.[88] What is a reasonable period is determined under DSU Article 21.3 by any one of the following three methods:

1. A period set by the DSB after a proposal by the member concerned,
2. A period agreed by the parties to the dispute, or
3. A period determined through binding arbitration within ninety days after adoption of the relevant report. In this case, the suggested period should not exceed

[77] DSU Art. 16.2. [78] DSU Art. 16.4. [79] Ibid.
[80] Ibid. Under DSU Art. 17.9, the Appellate Body has authority to draft its Working Procedures.
[81] DSU Art. 17.1. [82] DSU Art. 17.2 and 17.3. [83] DSU Art. 17.13.
[84] DSU Art. 17.5.
[85] DSU Art. 17.4. On the structure and functions of the Appellate Body, see Victoria Donaldson, 'The Appellate Body: Institutional and Procedural Aspects' in Patrick F. J. Macrory, Arthur E. Appleton, and Michael G. Plummer, eds., *The World Trade Organization: Legal, Economic and Political Analysis*, Vol. I (Springer, 2005) 1277–340; Mitsuo Matsushita, 'Some Thoughts on the Appellate Body' in Macrory, Appleton, and Plummer, eds., *The World Trade Organization* (2005) 1389–404.
[86] DSU Art. 21.3. [87] Ibid. [88] Ibid.

fifteen months from the date of the adoption of the report but may be shorter or longer depending on the circumstances.[89]

3.8.2 Compliance and the 'sequencing' problem

A problem with the implementation of WTO dispute settlement recommendations and rulings is the lack of guidance over what exactly a losing party must do to comply. The tendency has been for the losing party to take minimal steps and declare itself in full compliance. The winning party often disagrees.[90] One solution is to refer the matter to a compliance panel under DSU Article 21.5. In the *EC—Bananas* case,[91] the matter of compliance was referred to a WTO Panel that ruled that the revised EC banana regulations violated the GATT and the GATS. The Panel also ruled that no presumption of consistency or inconsistency attaches to regulations revised by a losing party.[92] But the winning party may not want to wait for the decision of a compliance Panel. In the *Bananas* case, at the United States' request, a WTO arbitral Panel established under DSU Article 22.6 set the amount of compensation authorized due to continued nullification or impairment of trade benefits.[93]

The confusion between the provisions of DSU Articles 21 and 22 is termed the 'sequencing' problem.[94] This problem arises because of a lack of coherence between the two Articles. First, Article 21.5 provides for an expedited compliance procedure:

> Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendation and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report.

Article 22.2, however, provides that if the losing party fails to bring its offending measure into compliance within twenty days of the expiry of the reasonable period allotted under Article 21.3, the winning party may request authorization from the DSB to retaliate by suspending trade concessions. The convening of a compliance Panel under Article 21.5 is not mentioned. Instead, Article 22.6 states that the DSB must grant authorization to suspend trade concessions within thirty days of the expiry of the reasonable period or refer the matter to arbitration, which shall be final.

[89] For example, 'U.S., Korea Clash Over Implementation of WTO Panel Dumping Ruling', *Inside U.S. Trade*, 16 April 1999.

[90] *EC—Bananas III (Article 21.5—Ecuador)*, Panel Report, WT/D27/RW/EEC, 12 April 1999.

[91] Ibid. para. 6.152.

[92] *EC—Bananas III (US) (Article 22.6—EC)*, Arbitration report, WT/DS27/ARB, 9 April 1999, para. 8.1.

[93] For greater detail, see Cherise M. Valles and Brendan P. McGivern, 'The Right to Retaliate under the WTO Agreement: The "Sequencing" Problem' (2000) *Journal of World Trade* 34(2), 63.

[94] 'Agreement on Dispute Settlement Changes Unlikely Before DOHA', *Inside U.S. Trade*, 3 August 2001, 1, 20.

Thus, as in the *Bananas* case, there appears to be, through an oversight in the drafting of the DSU, the possibility of an Article 21.5 compliance Panel and an Article 22.6 arbitration both proceeding on parallel and possibly conflicting courses. The confusion is compounded by the fact that there is no appeal from the arbitration but an appeal is possible from the compliance Panel.

This state of affairs cannot be dealt with adequately by interpretation; there must be a clarifying amendment of the DSU. This amendment should follow what appears to be the logical sequence intended: Article 22 should be amended so that retaliation may be invoked only after the conclusion of the Article 21.5 compliance determination process. Such an amendment has been proposed.[95] In current practice at the WTO, arbitration under Article 22 is suspended until the Article 21.5 compliance proceeding has run its course.

3.9 Compensation for failure to comply and retaliation

Two sanctions are specified if the recommendations and rulings of the DSB are not implemented within a reasonable period: compensation and retaliation (or suspension of concessions). Both sanctions are temporary. Neither is intended to be a substitute for implementing a recommendation or ruling to conform to the WTO agreements.[96]

The first option for sanctions is compensation. Compensation consists of additional trade concessions by the losing party, usually in related economic areas to the dispute, that are acceptable to the winning party as a substitute for maintaining the trade barriers in dispute. Compensation is voluntary and the subject of agreement between the parties to the dispute. If no satisfactory compensation is agreed within twenty days of the expiration of the reasonable period, any party having invoked the dispute settlement procedures may request authorization from the DSB to retaliate.[97]

The second option is retaliation (suspension of concessions). The level of retaliation authorized by the DSB must be equivalent to the nullification or impairment. There are three types of retaliation: (1) parallel retaliation by suspending concessions with respect to the same economic sector in which the nullification or impairment has been found; (2) cross-sector retaliation, which is the suspension of concessions relating to different sectors in the same agreement; and (3) cross-agreement retaliation, which is the suspension of concessions specified in a different agreement.[98] The preferred option is parallel retaliation; cross-sector and cross-agreement retaliation will be authorized only if parallel retaliation is impractical.[99]

Disputes over retaliation can be referred to arbitration if the losing party objects to the level of retaliation or appropriate procedures are challenged where the complaining party has requested cross-retaliation. The original Panel or an arbitrator appointed by

[95] DSU Art. 22. It is unclear whether the sanction procedure under Art. 22 can go forward before the Art. 21.5 and 21.6 procedures are complete. In *EC—Bananas*, the United States argued that Art. 22 may be invoked before the completion of Art. 21 proceedings. In fact, the WTO arbitrators released both findings at once. This seems to be a precedent that Arts. 21 and 22 proceedings can go forward simultaneously.

[96] DSU Art. 22.2. [97] DSU Art. 22.3. [98] DSU Art. 22.3(e).

[99] DSU Art. 22.6.

the Director-General carries out the arbitration.[100] The arbitration must be completed within sixty days.[101]

The DSB must both authorize and monitor the retaliation taken.[102] Unilateral retaliation is prohibited.[103] Retaliation is deemed temporary and will be terminated once the inconsistent measure has been removed, the losing party has provided a solution to the nullification or impairment of benefits, or the parties have reached a satisfactory solution.[104]

The United States has proposed that retaliation lists be rotated periodically to increase the pressure for compliance. The EC and other members oppose this so-called carousel procedure.

3.10 Special dispute resolution procedures

The DSU is primarily concerned with the settlement of disputes that involve an infringement of an obligation assumed under one or more of the WTO agreements. Such an infringement is considered a prima facie nullification or impairment of a trade benefit accruing to other WTO members. Following GATT practice, however, the DSU provides for dispute settlement concerning complaints that there is a nullification or impairment of benefits without an infringement of a WTO obligation. The DSU contains provisions for resolving two such complaints described in GATT Article XXIII: (1) non-violation complaints; and (2) situation complaints.

3.10.1 Non-violation complaints

In accordance with GATT Article XXIII:1(b), DSU Article 26.1 authorizes a complaint against 'a measure' by a member even if such a measure does not conflict with any WTO agreement, if the complaining member considers that any benefit under a covered agreement is being nullified or impaired or the attainment of any objective of a covered agreement is being impeded as a result of the application of the measure.

This procedure is available where not specifically excluded by the relevant covered agreement to secure the removal of trade barriers that impede market access even if there is no violation of the agreement. The burden of proof is on the complainant, which must present a 'detailed justification' of the complaint. This involves (1) defining the 'benefit' being nullified or impaired or the objective being impeded; (2) defining the 'measure' responsible; and (3) showing a causal relationship between the measure and the nullification or impairment or impeding of objectives.[105]

These three points are all rather vague. The meagre case law[106] on non-violation complaints suggests that 'benefit' refers to assurance of better market access; that

[100] Ibid. [101] DSU Art. 22.8. [102] DSU Art. 23.2. [103] DSU Art. 22.8.

[104] DSU Art. 26. See also Armin von Bogdandy, 'The Non-Violation Procedure of Article XX///:2: Its Operational Rationale' (1992) *Journal of World Trade* 26(4), 95, 101–8.

[105] For the major cases in which a non-violation complaint was dealt with, see the following: *Japan—Film*, Panel report, WT/DS44/R, 22 April 1998; *EC—Asbestos*, Panel report, WT/DS135/R, 18 September 2000; Appellate Body report, WT/DS135/AB/R, 5 April 2001.

[106] See *European Communities—Payments and Subsidies Paid to Processors and Producers of Oilseeds-Related Animal Feed Proteins*, 25 January 1990, GATT B.I.S.D. (37th Supp) at 86, para. 148 (1991). Often the benefit is a tariff concession. The Australian Subsidy on Ammonium Sulfate, 3 April 1950, GATT B.I.S. D. II at 188, para. 10 (1952); Treatment of Germany Imports as of 16–17 (1953).

nullification or impairment depends on a showing of adverse effect and frustration of reasonable expectations; that 'measure' may be a specific action or omission; and that the causal factor refers to a propensity to have an adverse effect, not any specific proof of a change in the volume of trade.[107]

Where the elements of a non-violation complaint are proved, however, there is no obligation to withdraw the measure in question. The Panel or the Appellate Body must recommend that the member concerned make a 'mutually satisfactory adjustment'.[108]

The non-violation complaint procedure may appear to lack teeth. Article 26.1(c), however, provides for non-binding arbitration 'upon the request of either party'. Arbitrators may determine the level of benefits impaired or suggest ways of resolving the dispute. Compensation may be part of a 'mutually satisfactory adjustment as final settlement of the dispute'. This procedure, although technically non-binding, places pressure on the parties to reach an agreement to resolve the dispute.

3.10.2 Situation complaints

In accordance with GATT Article XXIII:1(c), DSU Article 26.2 authorizes a complaint by a member that considers that any benefit under a covered agreement is being nullified or impaired or the attainment of any objective of the agreement is being impeded by the existence of 'any situation' other than those covered by the violation and non-violation complaint procedures. The chief utility of the situation complaint procedure is that causes of the frustration of market access expectations can be addressed other than measures. Presumably, the term 'situation' allows more nebulous conditions or states of affairs to be addressed. No Panels, however, have been called on to address 'situations' in the sixty-year history of the GATT/WTO.

The utility of the situation complaint procedure is very limited. Not only are the elements of such a complaint nebulous but also the only effect is that the findings of the Panel will be circulated to members. The Panel report may be appealed to the Appellate Body. The adoption of the Panel report as well as surveillance and implementation of recommendations and rulings is subject to pre-WTO rules that allow blocking and delay of Panel rulings.

3.11 Adverse inference

DSU Article 13.1 provides that each Panel has the right to seek information and technical advice from 'any individual and body' the Panel deems appropriate. This broad investigative power is essential if the Panel is to fulfil its mandate under DSU Article 11 to make an 'objective assessment of the matter before it, including an objective assessment of the facts of the case'.

In *Canada—Aircraft*, the Appellate Body ruled that Panels have authority to draw an adverse inference from the refusal of a party to supply necessary information without good reason.[109] This case involved an alleged subsidy by Canada to its aircraft industry

[107] DSU Art. 26.1(b). [108] In this sense, non-violation cases lack teeth.
[109] *Canada—Aircraft*, Appellate Body report (AB-1999), WT/DS70/AB/R, 2 August 1999, para. 203.

that Brazil regarded as contrary to the SCM (Subsidies and Countervailing Measures) Agreement. The Panel asked Canada for certain information related to the alleged subsidy. In response, Canada asked for a special procedure to protect proprietary information. The Panel complied, but Canada still refused to supply the information.

The Panel did not draw an adverse inference, and Brazil appealed this ruling to the Appellate Body. The Appellate Body upheld the Panel's discretion but stated that, under the circumstances of the case, the Panel could have drawn an adverse inference and could have found a violation of DSU Article 13, which concerns the Panel's right to seek information.

Canada—Aircraft, therefore, established the principle that an adverse inference may be drawn from non-cooperation of a party if the lack of cooperation is without any reasonable ground. After *Canada—Aircraft*, the Appellate Body confirmed that Panels and the Appellate Body may draw an adverse inference from non-cooperation on the part of a party to a dispute under certain circumstances.[110]

3.12 *Amicus curiae*

Whether or not Panels and the Appellate Body may accept and consider *amicus curiae* briefs from persons other than the parties to a dispute (the disputing parties and the third parties) has been a controversial issue. The recent rulings of the Appellate Body, however, show that the power of Panels and the Appellate Body to accept and consider *amicus curiae* briefs is an established principle. In the *Shrimp/Turtle* case,[111] the Panel declined to accept an *amicus curiae* brief, but the Appellate Body reversed this and stated that DSU Article 13.1 confers power on Panels to 'seek' information from any individual or body, and the power to 'seek' information should be interpreted to include the power to accept and consider *amicus curiae* briefs.

Subsequently, the Appellate Body ruled that two methods exist for the submission and consideration of *amicus curiae* briefs.[112] First, since it is up to each participant in a dispute settlement proceeding to determine what to include in its submissions, an *amicus curiae* brief may be submitted either to a Panel or to the Appellate Body with the consent of a participating WTO member.[113] Second, private organizations and individuals may submit *amicus curiae* briefs directly to a panel under DSU Article 13.1 and to the Appellate Body under DSU Article 17.9. In the *EC—Asbestos* case, the Appellate Body established a special procedure for accepting *amicus curiae* briefs.[114] A person submitting an *amicus curiae* brief must also submit a short summary of the

[110] See also *US—Wheat Gluten*, Appellate Body report (AB-2000-2-10), WT/DS166/AB/R, 22 December 2000, para. 172; *US—Upland Cotton*, Panel report, WT/DS267/R, 21 March 2005; *Korea—Commercial Vessels*, Panel report, WT/DS273/R, 11 April 2005.

[111] *US—Shrimp*, Appellate Body report (AB-1998-4), WT/DS58/R, 12 October 1998, para. 104.

[112] *Canada—Aircraft*, Appellate Body report (AB 1999), WT/DS70/AB/R, 2 August 1999, para. 203; *EC—Sardines*, Appellate Body report (AB 2002-3), WT/DS231/AB/R, 26 September 2002, paras. 156–7.

[113] In *US—Hot-rolled Steel*, Appellate Body report (AB 2000-1) WT/DS138/AB/R, 5 October 2000, para. 362, the Appellate Body first invoked DSU Art. 17.9 for this purpose, reasoning that if Panels are authorized to accept *amicus* briefs, the Appellate Body, which has authority to adopt its own working procedures, could do the same.

[114] *EC—Asbestos*, Appellate Body report (AB 2000-11), WT/DS135, AB/R, 12 March 2001, paras. 51–2.

brief limited to twenty pages and should not repeat the arguments of the parties. Whether to accept or consider an *amicus curiae* brief is up to the discretion of the panels and the Appellate Body.

At the meetings of the WTO General Council, certain WTO members, especially developing countries, have criticized the decision of the Appellate Body to consider *amicus curiae* submissions on the ground that the WTO is a contract among the members who have accepted it, and it is inappropriate to permit outside parties to influence adjudicative interpretations and decisions.[115]

Nevertheless, in the *EC—Sardines*[116] case, the Appellate Body accepted a portion of an *amicus curiae* brief submitted by the Government of Morocco, while rejecting as unhelpful an *amicus* brief submitted by a private party.

3.13 Burden of proof

Burden of proof is a rule to decide which of the disputing parties must prove the illegality or legality of the conduct in question.[117] In actuality, the term burden of proof comprehends two different but closely related legal issues: (1) which party has the burden of persuasion that the conduct in question was illegal; and (2) which party has the duty of going forward with relevant legal arguments and factual evidence. Although the Appellate Body has not explicitly made this distinction, we think that this point is essential to understand the issue of burden of proof and to make some of the Appellate Body rulings on this issue.

The first Appellate Body case on burden of proof, *US—Wool Shirts and Blouses*,[118] is regarded as foundational. In that case, the complaining party, India, argued that it was incumbent on the United States, the responding party, to prove that US import restrictions on shirts and blouses from India were not contrary to the 'safeguard' provisions of the WTO Agreement on Textiles and Clothing (ATC Agreement). India maintained that the United States had the burden of showing that its conduct was not contrary to the conditions of the safeguard provisions since the United States was invoking the provisions to justify its conduct and because the safeguard was an exception to the general provisions of the ATC Agreement. The Appellate Body disagreed, however, ruling that safeguard provisions of the ATC Agreement should not be regarded as exceptions, but rather functioned as affirmative rights.[119] Thus India as the complaining party must adduce prima facie evidence and legal argument to

[115] General Council Meeting on 22 November 2000, WT/GC/38 (12 December 2000).

[116] *EC—Sardines*, Appellate Body report, paras. 153–70. For details of issues surrounding *amicus curiae* briefs, see C. L. Lim, 'The Amicus Brief Issue at the WTO' (2005) *Chinese Journal of International Law* 4(1), 85–120.

[117] For a detailed study of the allocation of burden of proof, see Michelle T. Grando, 'Allocating the Burden of Proof in WTO Disputes: A Critical Analysis' (August 2006) *Journal of International Economic Law* 9(3), 615–56.

[118] *US—Shirts and Blouses*, Appellate Body report, WT/DS33/AB/R, 25 April 1997.

[119] It should be noted that the ATC Agreement was transitory in nature, that is, it was an agreement to last only for five years after the coming into being of the WTO. It was a transition process from the MFN Agreement (the Multi-fibre Agreement) to GATT Art. XIX. Therefore, the ATC Agreement represented 'a world of imperfection' in which import restrictions (safeguards) were not exceptions.

prove the illegality of the conduct in question. After such proof is established, the respondent has the duty to rebut the complaining party's proof with appropriate argument and evidence.

In *US—Shirts and Blouses*, the Appellate Body recognized that it is up to the complainant to present evidence and argument sufficient to establish a presumption that a measure is inconsistent with WTO obligations. It is then up to the respondent member to bring evidence and argument to rebut the presumption.[120] This is the holding of the Appellate Body which established the rule on burden of proof in WTO litigation. This line of reasoning with regard to burden of proof has been followed in the subsequent rulings of the Appellate Body.

In *EC—Hormones*,[121] the EC imposed a ban on domestic sale and import of beef taken from animals treated with six kinds of hormones. An international standard formulated by the Codex Commission stated that, with respect to two hormones, beef products involved no recognizable risk as long as the residue of hormones remained within the limit stated in the standard. The United States and Canada filed a complaint with the WTO alleging that this EC measure was contrary to the SPS. The Panel stated that the measure in question was contrary to the SPS. The Appellate Body upheld the Panel's finding and held also that the EC measure was contrary to the SPS.

With regard to burden of proof, the Panel held that it was incumbent on the complaining party to adduce evidence that the responding party's measure was not based on a sufficient risk assessment under Article 3.1 of the SPS Agreement. The Panel also held that it was the responsibility of the party which had invoked a measure under Article 3.3 of the SPS Agreement to prove that its measure would be justified under this provision although not based on an international standard. The Panel found that Articles 3.1 and 3.3 of the SPS Agreement had a general rule–exception relationship in which Article 3.3 operates as an exception to the general rule in Article 3.1 and whoever invokes an exception to the general rule is responsible to prove that its measure is justifiable under the provision granting exception.

The Appellate Body reversed both of those holdings of the Panel and stated that the party challenging a SPS measure of another member was responsible for proving that the measure was contrary to the SPS and also that the measure could not be justifiable by a provision for derogation.[122] In the view of the Appellate Body, Article 3.3 is not an exception to the general rule incorporated in Article 3.1 but it simply excludes from its scope of application the kinds of situations covered by Article 3.3 and gives it special right. On this basis, the Appellate Body held that it was incumbent on the complaining party to adduce evidence to show that the responding party's measure was contrary to Article 3.1 and did not satisfy the requirement of Article 3.3 of the SPS Agreement. The Appellate Body stated that this conclusion did not affect the general rule that a complaining party has the burden of proving a prima facie case of inconsistence.[123]

[120] *US—Shirts and Blouses*, WT/DS33/AB/R/DSR 1997:1, 323, 23 May 1997, 13.

[121] *EC—Hormones*, Appellate Body report, 13 February 1998.

[122] Generally a derogation clause provides that one can choose not to adhere to the rule established in another provision of a law or treaty under the conditions stipulated in the clause.

[123] *EC—Hormones*, paras. 103–4.

Another recent SPS case in which the issue of burden of proof under this Agreement was taken up is *EC—GMO*.[124] In 2003, the United States, Canada, and Argentina took the EC to the WTO on the ground, inter alia, that the EC violated provisions of the SPS by imposing a moratorium with respect to approval of import of agricultural products produced with biotechnology (GMO products). The Panel published a report in 2006 in which it approved some EC measures but invalidated some others. In this case, six members of the EC invoked temporary safeguards prohibiting import of GMO products and the complainants challenged this. The EC invoked Article 5.7 and argued that the measures in question were justified by this provision. The Panel examined the relationship between Articles 2.2 and 5.1 of the SPS on the one hand and Article 5.7 of the SPS on the other. Article 2.2 of the SPS requires that members base their SPS measures on sufficient scientific evidence and Article 5.1 requires that members run risk assessment with regard to SPS measures[125] that they intend to adopt and allows them to enforce such measures only when such measures are supported by sufficient scientific evidence. On the other hand, Article 5.7 of the SPS allows members to adopt temporary SPS measures on the basis of available evidence in accordance with the requirements stipulated in that Article when sufficient scientific evidence is not available. The question here was the burden of proof with respect to the relationship between Articles 2.2 and 5.7 of the SPS and Articles 5.1 and 5.7 thereof.

The Panel made a general statement by citing the *EC—Tariff Preferences* case[126] that when a provision of a treaty permits a measure under certain conditions which would be inconsistent with another provision of the treaty if a permission was not granted under such conditions, the claimant who alleged a violation of the provisions bore the burden of proving (a) that the measure in question was inconsistent with the latter provision and (b) that it did not satisfy the conditions for permission. The Panel then examined the relationship between Articles 2.2 and 5.7 of the SPS Agreement.

Article 5.7 of the SPS permits members to take temporary SPS measures when there is no sufficient evidence to take SPS measures in accordance with Article 2.2 of the SPS. Article 2.2 refers to Article 5.7 by the phrase 'except as provided for in paragraph 7 of Article 5'. For this reason, the Panel said that Article 5.7 is not an exception to Article 2.2 but creates an independent right for a party invoking it. The Panel held that the claimant alleging a violation of Article 2.2. of the respondent's SPS measure must prove also that the respondent measure was not permitted by Article 5.7 of the SPS. Likewise the Panel held that the claimant was responsible to prove that the respondent's SPS measure was inconsistent with Article 5.1 and also that it was not allowed by Article 5.7. In conclusion, the Panel held that the EC measures were in violation of Article 5.1 and were not permitted by Article 5.7.

[124] *EC—Approval and Marketing of Biotech Products*, WT/DS291, 292, 293/R.

[125] Risk assessment in a narrow sense means a scientific examination of whether a substance generates hazards to life and health. In a broad sense, however, it includes an assessment of 'risk management', that is, an assessment of manageability or controllability of risk. For example, a risk may be small in scientific experiment but there may be circumstances in which it is difficult administratively to prevent such risk from spreading widely. Proper risk assessment should take into account both scientific aspect and administrative or managerial aspects.

[126] *EC—Tariff Preferences*, Panel report, WT/DS246/R, 1 December 2003; Appellate Body report, WT/DS246/AB/R, 7 April 2004.

In subsidy areas, a similar issue arose. In *Brazil—Aircraft*,[127] the Appellate Body held that the sentence in Article 27.2 of the SCM Agreement which states 'The prohibition of paragraph (a) of Article 3 shall not apply to: (a) developing country Members referred to in Annex VII, (b) (omitted)' does not grant an exception from Article 3.1 (a) which prohibits subsidies but conferred an independent right to members invoking it. Thus the burden of proof is on the claimant to establish that the respondent's measure did not satisfy the requirement of Article 27.2 of the SCM Agreement.

The latest case in line with the above series of appellate rulings is *India—Additional Import Duties*[128] in which India imposed certain additional duties on imports of alcoholic products in addition to regular duties. The United States, the claimant, brought a case against India on the ground that this amounted to an imposition of import duties in excess of the concession which India had made under GATT Article II:1(b). India argued that these additional taxes were imposed as border tax adjustments under GATT Article II:2(a) and, therefore, should be justified. The Appellate Body ruled that Article II:1(b) and Article II:2(a) are 'closely inter-related provisions' and the United States was required to present arguments and evidence that the Indian additional duties were not justified under Article II:2(a).

In discussing the burden of proof issue, the Appellate Body noted that it was incumbent on the United States as the complaining party to establish a prima facie case in violation of GATT Article II:1(b) as well as to present arguments and evidence that the additional duties were not justified under Article II:2(a).[129] Then India was required to produce arguments and evidence that the additional duties were allowable under Article II:2(a). Following India's rebuttal, the burden shifted to the United States to rebut India's rebuttal with appropriate legal argument and evidence.[130] Thus, in this case the Appellate Body ruled that the United States had the burden of persuasion and the initial burden of going forward with arguments and evidence with respect to both the affirmative provision of the GATT (Article II:1(b)) as well as the relevant provision for border tax adjustment (Article II:2(a)). But at this point, the duty of going forward with arguments and evidence shifted to India. After India's submission of arguments and evidence, the duty of going forward returned to the United States. As the Appellate Body stated, 'Once the responding party seeks to rebut arguments and evidence offered by the complaining party, the complaining party, depending on the nature and content of the rebuttal submission, may need to present additional arguments and evidence in order to prevail on its claim.'[131] The Appellate Body thus made clear that although the ultimate burden of persuasion in a WTO case rests on the complaining party, the burden of going forward with arguments and evidence can shift from party to party, depending on the circumstances of the case.

In all of the above rulings of the Appellate Body, the following formula seems to apply. Provision A in an agreement prohibits Measure X, Provision B in the same agreement permits Measure X under certain conditions (the derogation clause) and either Provision A or Provision B refers to the other or both are closely interrelated,

[127] *Brazil—Aircraft*, Appellate Body report, WT/DS46/AB/R, 2 August 1997.
[128] *India—Additional Import Duties*, Appellate Body report, WT/DSD360/AB/R, 30 October 2008.
[129] Ibid. para. 190. [130] Ibid. para. 191. [131] Ibid. para. 191.

then Provision B is not an exception. Provision B is a provision excluding members from application of the rule in Provision A and providing an independent right to members invoking it. In this situation, the claimant which alleges that the respondent's measure is in violation of Provision A is required to prove not only that it is contrary to Provision A but also that it does not satisfy the requirement for Provision B.

There is another series of Panel and appellate rulings in which 'exceptions' to general rules are dealt with. In those cases, the principle enunciated is somewhat different. In *United States—Gasoline*, one of the issues was whether the US measures to deal with air pollution fell under GATT Article XX. Speaking of burden of proof as to whether the measure in question goes against the chapeau of Article XX, the Appellate Body stated: 'The burden of demonstrating that a measure provisionally justified as being within one of the exceptions set out in the individual paragraphs of Article XX does not, in its application, constitute abuse of such exception under the chapeau, rests on the party invoking the exception . . . '[132] In *EC—Asbestos*, the EC was accused by Canada of violating GATT Article III for the reason that it had prohibited the sale and importation of asbestos while permitting the sale and importation of like products. The Panel stated: 'We consider that the reasoning of the Appellate Body in *United States—Shirts and Blouses* from India is applicable to Article XX, in as much as the invocation of that Article constitutes a "defense" in the sense in which that word is used in the above-mentioned report. It is therefore for the European Communities [the respondent] to submit in respect of this defense a prima facie case showing that the measure is justified.'[133] This part of the report was not reviewed by the Appellate Body.

The above line of appellate and Panel reports shows that, in invoking exceptions incorporated in GATT Article XX, the party invoking paragraphs of Article XX and chapeau is responsible for demonstrating that the challenged measure falls under them and is justifiable. This is continued in *EC—Tariff Preferences* in which the Enabling Clause was at issue. In this dispute, the EC made a 'drug arrangement' with some developing countries granting them tariff preferences. On being excluded from this preferential treatment, India brought a claim against the EC that this differential treatment violated GATT Article III. The EC claimed that this preferential treatment was allowed under the Enabling Clause which states 'Notwithstanding the provisions of Article I of the General Agreement, Members can confer preferential tariffs to developing country Members'.

Generally the Appellate Body followed the precedents on Article XX in *EC—Tariff Preferences*. However, it provided a different twist in this case. According to the Appellate Body, the burden of proof for an exception falls on the respondent and from this allocation of the burden of proof, 'it is normally for the respondent, first, to raise the defense and, second, to prove that the challenged measure meets the requirements of the defense provision.'[134] However, the Appellate Body added that, in a case involving the Enabling Clause, the complainant has to define parameters within which the respondent makes a defence in its complaint. According to the Appellate Body, the

[132] *United States—Gasoline*, WT/DS/AB/R/DSR 1996:1, 3, para. 17.
[133] *EC—Asbestos*, Panel report, paras. 8.177–8.188.
[134] *EC—Tariff Preferences*, WT/DS246/AB/R, 20 April 2004, paras. 104 and 105.

responsibility of the complainant is merely to identify those provisions of the Enabling Clause with which the scheme is allegedly inconsistent without bearing the burden of establishing the facts necessary to support such inconsistency.[135] Here the Appellate Body somewhat aggravated the burden of proof on the part of complainant in cases in which the Enabling Clause is at issue.

The above review of Panel and appellate rulings seems to indicate that there is a distinction between the burden of proof in respect of the SPS, the TBT, and the SCM Agreement on the one hand and that in respect of GATT Article XX and the Enabling Clause on the other. The Appellate Body explains that this difference comes from the fact that, in the SPS, the TBT, and the SCM agreements, a derogation clause allowing members to take measures which would contravene the prohibitions incorporated in those agreements but for that derogation clause is not an exception, but it provides a right to take such a measure. The Appellate Body arrives at this conclusion by comparing the literal structures of the relationship between the relevant provisions and the derogation clauses in the SPS, the TBT, and the SCM agreements to Article XX, the Enabling Clause, and provisions in the GATT from which exceptions Article XX/the Enabling Clause provide. This dichotomy seems to be somewhat artificial. However, this follows from the principle of literal interpretation which has been adopted by the Appellate Body.

3.14 Judicial economy

Judicial economy is a recognized principle of the judicial and administrative process whereby an adjudicating body is authorized to deal only with issues necessary to dispose of the dispute in question while skipping other issues raised by the parties. In the WTO, while Panels are free to employ judicial economy, DSU Article 17.12 states that the Appellate Body shall address each of the issues raised during the appellate proceeding. Therefore, contrary to the practice of Panels, the Appellate Body is not free to exercise judicial economy. The reason for this difference comes from the role assigned to the Appellate Body. The Appellate Body is charged with the responsibility not only of resolving disputes but also of establishing interpretations of WTO agreements. Therefore, the Appellate Body must address each legal issue raised in an appellate proceeding regardless of whether it is necessary to resolve the dispute.

Korea raised this issue in the *US—Line Pipe* case.[136] In that case, which involved a safeguard measure by the United States, Korea raised a claim regarding the non-application of a safeguard measure to members of a free trade agreement under GATT 1994 Article XXIV. The Appellate Body, however, did not deal with this issue on the ground that the dispute had been resolved by its holding on ‘parallelism’. In light of the text of DSU Article 17.12, which states that the Appellate Body shall deal with each legal issue raised in an appellate proceeding, the dismissal by the Appellate Body of the issue raised by Korea regarding the applicability of GATT 1994 Article XXIV is problematic.

[135] Ibid. paras. 114–15.
[136] *US—Line Pipe*, Appellate Body report (AB-2002-1), WT/DS202/13/AB/R, 15 February 2002.

3.15 Standard of review

DSU Article 11 states that a Panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability and conformity with the relevant covered agreements. This requires that a Panel treat pieces of evidence produced before it with objectivity and not distort or ignore them and that a Panel analyse the matter before it without bias and reach a reasonable conclusion. In short, this means that a Panel must observe due process of law.[137] To facilitate this, DSU Article 13 accords Panels a wide scope of investigative power, including the power to seek information from any individual or body, and members are obligated to cooperate and provide information requested by a Panel. Although DSU Articles 11 and 13 do not refer to the Appellate Body, it is obvious that the Appellate Body is under the obligation to observe due process of law as well.

One of the issues with regard to the standard of review for Panels is how much weight should the Panel give to fact-finding by the authority of the member in question. The question is whether the Panel should defer to the fact-finding of the domestic authority (deference principle) or can engage in independent fact-finding on its own initiative (*de novo p*rinciple). The Appellate Body stated that the Panel should rely on either the deference principle or the *de novo* principle in fact-finding. Instead, the Panel must rely on the test enunciated in DSU Article 11 for its objective assessments of fact and law. For example, it should test whether the explanations for the conclusions reached by the domestic authority are reasoned and adequate in the light of other plausible alternative explanations.[138]

Article 17.6(i) of the Antidumping Agreement provides for a special standard of review for antidumping proceedings. This Article requires that if the establishment of facts by a national antidumping authority was proper and the evaluation was unbiased and objective, even though the Panel might have reached a different conclusion, the Panel shall not overturn the evaluation. Article 17.6(ii) of the Antidumping Agreement requires that where the Panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the Panel shall find the national anti-dumping authority's measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.

When one compares the wording of Article 17.6 of the Antidumping Agreement and DSU Article 11, one might have the impression that Article 17.6 declares a deference principle according to which WTO bodies are obligated to respect determinations of national antidumping authorities as an exception to DSU Article 11. However, in *US—Hot-rolled Steel*,[139] the Appellate Body stated that Article 17.6 of the Antidumping Agreement is supplementary to DSU Article 11 with regard to antidumping matters and should not be interpreted as superseding DSU Article 11. This interpretation seems reasonable since DSU Article 3.2 requires Panels and the Appellate Body to interpret

[137] This was the explicit determination of the Appellate Body in *Chile—Price Band System*, Appellate Body report (AB 2002-2), WT/DS207/AB/R, 23 September 2002.

[138] *US—Tyres (China)*, WT/DS399, AB/R, adopted 5 October 2011, para. 280.

[139] *US—Hot-rolled Steel*, Appellate Body report, WT/DS184/AB/R, 23 August 2001.

provisions of WTO agreements, including DSU Article 11, according to the established rules of public international law for interpreting treaties (which are incorporated in the Vienna Convention), and Article 17.6 of the Antidumping Agreement contains the requirement that the rules of interpretation established in public international law should be observed. Therefore, both DSU Article 11 and Article 17.6 of the Antidumping Agreement incorporate the same rules of interpretation as expressed in Article 31(1) and (2) of the Vienna Convention.

There are two principles with regard to standards of review: the deference principle and the *de novo* principle. Under the deference principle, WTO bodies defer to findings of the national authority and do not, in principle, engage in new findings of fact or law unless the findings of the national authority are clearly unreasonable. Under the *de novo* principle, WTO bodies take a more active role and use evidence that was not before the national authority. Neither of these principles has been applied in their extreme forms. Panels and the Appellate Body have taken a middle-of-the-road approach and applied a test which is a mixture of these two principles depending on the particulars of the case concerned. In *EC—Hormones*,[140] the Appellate Body stated that the proper standard of review is neither the deference principle nor the *de novo* principle, but the proper test is 'the objective assessment' as provided for in DSU Article 11.

In *Guatemala—Cement I*,[141] the Appellate Body enunciated the deference principle by stating: 'in our review of the investigative authorities' evaluation of the facts, we will first need to examine evidence considered by the investigating authority. That is, we are not to examine any new evidence that was not part of the record of the investigation'. This expresses the deference principle with regard to fact-findings and, according to this rule, Panels should not look for facts that were not before the investigating authority.

However, the later trend of Appellate Body rulings seem to shift toward 'judicial activism'. In *Thailand—H-Beams*,[142] the issue was an interpretation of Article 3.1 of the Antidumping Agreement. The Appellate Body stated that Panels are given broad authority to investigate whether the antidumping authority of a member did a proper job in fact-finding, and suggested that Panels can examine not only evidence before the antidumping authority but also other evidence. This seems to be a departure from the principle established by *Guatemala—Cement I*.

An interesting aspect of this ruling by the Appellate Body is that it allowed the Panel to base its findings on evidence not shown to the parties. This finding may invite criticism that parties are not accorded a sufficient opportunity to be heard.[143]

This trend was exhibited again in *US—Lamb*[144] in which the issue was the scope of review by the Panel of fact-findings by the US International Trade Commission. The Panel took the view that its task was limited to a review of the determination made by

[140] See n. 121.

[141] *Guatemala—Cement I*, Appellate Body report, WT/DS60/AB/R, 25 November 1998.

[142] *Thailand—H-Beams*, Appellate Body report, WT/DSD122/AB/R, 5 April 2001.

[143] For discussions of standard of review, see Claus-Dieter Ehlermann and Nicolas Lockhart, 'Standard of Review in WTO Law' (2004) *Journal of International Economic Law* 7(3), 491–521.

[144] *US—Lamb*, Panel and Appellate Body reports, WT/DS177; WT/DS178, 16 May 2001.

the US International Trade Commission and to examining whether the published report provides an adequate explanation of how the facts as a whole support the determination of threat of injury by the US International Trade Commission. However, the Appellate Body stated that a panel need not confine itself to the arguments of the investigating authority, and must be open to the possibility that the explanation given by the competent authorities is not reasoned or adequate.

However, in *US—Cotton Yarn*,[145] the Appellate Body stated that Panels must not conduct a *de novo* review of the evidence and should not substitute their judgment for that of the competent authority.

On the whole, however, it seems that a departure from the rule established by *Guatemala—Cement I* is clear. The question is whether this trend will continue in future. If the investigative powers of Panels are extended beyond a certain limit, there may be criticism that WTO bodies act beyond their authority.

DSU Article 17:6 states: 'An appeal shall be limited to issues of law covered in the panel report and legal interpretation developed by the panel'. In light of this provision, it is clear that a review by the Appellate Body is limited to 'legal issues' rather than 'factual issues'. However, legal issues can be interpreted liberally and include not only interpretations of WTO agreements in a narrow sense of the term but also such things as the characterization of law in a member, for example, a question of whether a member's law is an antidumping law or competition law.[146]

3.16 A critique of the DSU

The WTO dispute settlement system is a valiant attempt to subject controversies over international trade to the rule of international law. This ambitious goal will be advanced if this system continues to be respected, especially by larger states, so that rule-oriented settlements prevail over power-oriented dispute settlement. The WTO system has unabashedly adopted the judicial model of dispute settlement.

This effort deserves high praise, but, even if it is successful, there have been some criticisms raised against the dispute settlement process at the WTO. Some argue that the Appellate Body has overstepped the boundary assigned to it and, in fact, 'made law' instead of interpreting law.[147] We refrain from making any judgement as to whether the Appellate Body has overstepped its boundaries or not. However, the Appellate Body has the final word in a dispute settlement since the report of the Appellate Body in a dispute is adopted automatically by negative consensus voting at the DSB, and the winning party always favours its adoption. Even if the Appellate Body makes a mistake, there is no mechanism to correct it. In a domestic jurisdiction, if the Supreme Court makes a mistake, the legislature can enact a law to correct it. However, in the WTO process, the political branch (the General Council and the Ministerial Conference) does not commonly exercise this power.

[145] Appellate Body report, WT/DS192/AB/R, 5 November 2001.

[146] *China—Auto Parts*, WT/DS339.340.342/AB/R, adopted 12 January 2009, paras. 224–5.

[147] Clause E. Barfield, *Free Trade, Sovereignty, Democracy, The Future of the WTO* (American Enterprise Institute, 2001) 44.

This means that there are no effective 'checks and balances' operating within the WTO. One way to correct this omission is to modify Article IX:2 of the WTO Agreement to allow the adoption of an interpretation of a WTO agreement by two-thirds or a simple majority of the members. However, this would mean that the General Council or the Ministerial Conference could overturn a 'judicial or quasi-judicial' decision of a Panel or the Appellate Body for political reasons. This would be contrary to the idea of establishing a judicialized dispute settlement process.

Another solution may be to create a peer review group in the WTO that would examine reports of the Appellate Body, criticize them if there is any problem of interpretation, and periodically publish the results. This group would have no power to overturn the rulings of the Appellate Body, but the Appellate Body could study the reports of this group and gain insight from them. This peer review group would consist of legal experts with established reputations in international law or WTO law, such as academics, judges, and practising lawyers.[148]

WTO members would be excluded because the purpose of this 'peer review' is not to determine whether rulings of the Appellate Body are politically palatable, but to judge whether they are legally sound and balanced. WTO members already have the opportunity to express their views when the DSB adopts a report of the Appellate Body.[149]

There is also a need for alternative dispute resolution methods and more diplomatic and negotiation-based dispute settlement. GATT 1947's numerous provisions for diplomatic consultation as well as the DSU's authorization of conciliation, mediation, good offices, arbitration, and expert review are largely overshadowed by the quasi-judicial procedures and the strict timetables of the Panels and the Appellate Body. While the WTO system is a vast improvement, there is a need to increase the role of the alternative dispute settlement systems that may be more suited to certain types of disputes than the rule-based system.

There is also a need to open the dispute settlement process to allow greater transparency and participation by non-governmental organizations.[150] In addition, there is a need to expand the resources of developing countries to allow them to participate more effectively in the system.

[148] *The Sutherland Report* (see n. 1) proposes that a group of experts be established to review rulings of the Appellate Body and, if the group thinks it appropriate, recommends that the General Council exercises its power to adopt an exclusive interpretation of provisions of WTO agreements under Art. XI:2 of the WTO Agreement (see 49–59 of the *Report*).

[149] But see Jeffrey L. Dunoff, 'The Misguided Debate over NGO Participation at the WTO' (1998) *J. Int'l Econ. L.* 1, 433, 453–6.

[150] There are proposals to allow private parties to proceed directly in the WTO. See, for example, Thomas J. Schoenbaum, 'WTO Dispute Settlement: Praise and Suggestions for Reform' (1998) *Int'l & Comp. L.Q.* 47, 647, 653–8.

5

Enforcement of WTO Obligations

Remedies and Compliance

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1. Overview: Implementing the DSB's 'Recommendations and Rulings'

An adopted Panel or Appellate Body report is a binding decision ('recommendation or ruling') by the General Council of the WTO convened as a Dispute Settlement Body, DSU Article 21.1, and shall be unconditionally accepted by the parties to the dispute, DSU Article 17.14. Pursuant to DSU Article 21.3, 'losing' members have to inform the DSB of their 'intentions in respect of implementation of the recommendations and rulings of the DSB'.[1] Pursuant to DSU Articles 21.1 and 3.7, a 'losing party' must

[1] DSU Art. 21.3; see Alan Yanovich and Werner Zdouc, 'Procedural and Evidentiary Issues' in Daniel Bethlehem, Donald McRae, Rodney Neufeld, and Isabelle Van Damme, eds., *The Oxford Handbook of International Trade Law* (Oxford: Oxford University Press, 2009) 371 *et seq*.

promptly (immediately) bring its measures into compliance with its WTO obligations—not less, not more.[2] In contrast to the general law of state responsibility, no compensation is due, that is, WTO law does not establish the obligation to undo the economic consequences of the internationally wrongful act that is the breach of the WTO Agreement. These efforts have to be completed within a *reasonable period of time* (RPT), defined either bilaterally, through an agreement between the parties, or multilaterally by resorting to arbitration (see section 5 of this chapter). If the parties disagree as to whether compliance has been achieved, the parties to the original dispute will submit their new dispute to *a compliance Panel* (see section 6 of this chapter) whose decision may be appealed to the Appellate Body.

In practice, WTO members fulfil these obligations remarkably well: compliance with adopted WTO Panel and Appellate Body reports is high.[3]

If, however, a WTO member fails to comply with the 'recommendations and rulings' of the Dispute Settlement Body (DSB),[4] DSU Article 22 offers temporary (DSU Article 22.1) 'second-best' options: mutually agreed compensation or the suspension of concessions or other obligations by the successful complaining party vis-à-vis the defending party.

Whereas the former is a voluntary and transitional buy-out—possibly in the form of a temporary re-balancing of reciprocal rights and obligations—the latter are temporary[5] enforcement measures, inflicted unilaterally, but pursuant to multilateral standards and supervision; they are supposed to bring about the *specific performance* due.

Such measures—often also labelled as *retaliation* (retaliatory) *measures*—typically raise the (bound) duties for certain goods originating in the member whose WTO-incompatible behaviour had given rise to the dispute settlement procedure. As will be shown later, however, the DSU does not exclude the suspension of other obligations, and members have availed themselves (with the authorization of the DSB) of that

[2] DSU Art. 3.7 reads in pertinent parts: 'In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement. The last resort which this Understanding provides to the Member invoking the dispute settlement procedures is the possibility of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorization by the DSB of such measures.'

[3] cf. the statistical data in Kara Leitner and Simon Lester, 'WTO Dispute Settlement 1995–2014—A Statistical Analysis' (2015) *Journal of International Economic Law* 18, 203–14.

[4] DSU Art. 21.1 demands prompt compliance; Art. 21.4 states that eighteen months is the maximum period of delay, unless otherwise agreed or decided.

[5] Art. 22.1 states that: 'compensation and the suspension of concessions or other obligations are temporary measures ...'. Furthermore, Art. 22.8 reads in part: 'the suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed ...'. The notion that the suspension of concessions or other obligation is temporary was reiterated in the often cited *EC—Banana III (US)* in which the Appellate Body at para. 6.3 further indicated that the purpose of a countermeasure is to *induce compliance*. This principle has become settled law and as indicated by the Arbitrator in *US—Upland Cotton*, para. 4.112: '"Inducing compliance" appears rather to be the common purpose of retaliation measures in the WTO dispute.'

possibility.[6] If the *concerned party* objects, the dispute will be submitted to an Arbitrator (usually the members of the original Panel) who will then decide on the appropriate level of countermeasures to be imposed (see section 7 of this chapter).

However, WTO members have not often had recourse to enforcement measures explicitly provided for in Article 22.[7]

2. Remedies in Cases of Successful Non-violation and Situation Complaints

Whereas the remainder of this chapter focuses on the implementation of successful *violation complaints*, this section addresses the implementation of successful *non-violation*[8] or *situation complaints*,[9] albeit in a most cursory fashion.[10] Both of these complaints are characterized by the fact that they do not undertake to challenge the WTO-compatibility of measures taken by a fellow member, but rather, despite the absence of active wrongdoing, claim nullification and impairment of WTO Agreement-based benefits.

In light of this constellation, the negotiators refrained from extending the hard-and-fast rules of the regular DSU decision-making and enforcement mechanism to these special types of complaints, no doubt taking into account that both the non-violation and the situation complaint have played a limited role in GATT/WTO practice.[11]

[6] Cross-retaliation, as this is called, has been (at the time of writing) authorized in three cases: *EC—Bananas III (Ecuador) (Article 22.6—EC)* (Arbitration), *US—Gambling (Article 22.6—US)* (Arbitration), and *US—Upland Cotton (Article 22.6—US)* (Arbitration); see also Werner Zdouc, 'Cross-retaliation and Suspension under the GATS and TRIPS Agreements' in Chad P. Bown and Joost Pauwelyn, eds., *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (Cambridge University Press, 2010) 515–35 and Lucas Eduardo F. A. Spadano, 'Cross-agreement Retaliation in the WTO Dispute Settlement System: An Important Enforcement Mechanism for Developing Countries?' (2008) *World Trade Review* 7, 511–45.

[7] To date, requests for authorization to retaliate pursuant to DSU Art. 22.2 have been filed in twenty-two cases, while the total number of requests is thirty-six (in certain disputes with multiple complainants, there were multiple requests, see <http://www.worldtradelaw.net/databases/retaliationrequests.php>). Authorization to retaliate by the DSB pursuant to DSU Art. 22.6 was granted in nine cases: *EC—Bananas III*; *EC—Hormones*; *Brazil—Aircraft*; *US—FSC*; *US—1916 Act*; *Canada—Aircraft Credits and Guarantees*; *US—Offset Act*; *US—Upland Cotton*; and *US—Gambling*; see the very helpful statistical data at <http://www.worldtradelaw.net/databases/suspensionawards.php> and the WTO website <https://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm>.

[8] DSU Arts. 3.1 and 26.1 and GATT Art. XXIII:1(b). For a critical analysis of WTO non-violation complaints see Christophe Larouer, 'WTO Non-Violation Complaints: A Misunderstood Remedy in the WTO Dispute Settlement System' (2006) *Netherlands International Law Review* 53, 97–126.

[9] DSU Art. 26.2; see also Ernst-Ulrich Petersmann, 'Violation and Non-Violation Complaints in Public International Trade Law' (1991) *German Yearbook of International Law* 34, 175–231 for an excellent overview of the GATT 1947 practice with respect to non-violation complaints.

[10] For more detailed information see Dae-Won Kim, *Non-Violation Complaints in WTO Law, Theory and Practise*, Studies in Global Economic Law, Vol. 9 (Bern et al.: Peter Lang, 2006); Robert W. Staiger and Alan O. Sykes, 'Non-Violations' (2013) *Journal of International Economic Law* 16, 741–75; Susy Frankel, 'Challenging Trips-Plus Agreements: The Potential Utility of Non-Violation Disputes' (2009) *Journal of International Economic Law* 12, 1023–65.

[11] cf. the WTO Analytical Index (2012) (<https://www.wto.org/english/res_e/booksp_e/analytic_index_e/dsu_09_e.htm#1355>); non-violation complaints were unsuccessfully filed in *US—Gasoline*, *EC—Hormones*, *Japan—Film*, *EC—Asbestos*, *Korea—Procurement*, *US—Offset Act (Byrd Amendment)*, *China—Auto Parts*, *US—COOL*, *EC—Seal Products*; no situation complaint has been used since 1994.

- If a *non-violation complaint* convinces a Panel and/or the Appellate Body, the respective adjudicative body will recommend a *mutually satisfactory adjustment*.[12] To facilitate the resolution of the dispute, an Arbitrator may, upon request, determine the level of benefits which have been impaired. Very much in contrast to the regular procedure, such a determination is *not binding* on the parties to the dispute.[13] Recourse to *compensation* (itself, a voluntary option) can be part of a mutually satisfactory adjustment.[14]
- A successful *situation complaint* benefits even less from the elaborate enforcement mechanisms provided by the DSU. Its Article 26.2 makes it clear that these rules of the DSU apply 'only up to and including the point in the proceedings where the panel report has been circulated to the Members'. Considering the GATT's positive consensus rule, the adoption of the Panel report and certainly any subsequent implementation depends on the consent of the state that, according to the evaluation of the adjudicating body, would have to change the status quo.

3. The Starting Point: Rulings and Recommendations Based on Recommendations and Suggestions Pursuant to DSU Article 19

DSU Article 19.1 reads as follows:

> Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement. In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations.

The *recommendation* made by the WTO Panel or the Appellate Body pursuant to DSU Article 19.1 turns into a ruling by the DSB (cf. DSU Article 21.3 and 21.5 which speak of *recommendation and ruling*) upon being adopted (DSU Articles 16.4, 17.14).[15] The DSB will (upon the pertinent recommendation of the adjudicative body) 'request' the losing party to bring its measure into conformity with WTO law. Therefore, the DSU provision that lays down what Panels and the Appellate Body recommend *to the DSB*, Article 19, also defines the remedies provided for by the DSU for breach of WTO Agreement obligations. DSU Article 19 is one of the central legal foundations for the legitimation of the continuation of the GATT 1947 practice to provide as a remedy against treaty violations only the obligation to discontinue the illegal act and to 'bring the measure into conformity' with GATT (and now WTO) law.

[12] No provision requires members to withdraw a measure that *is* compatible with WTO law.
[13] DSU Art. 26.1 lit. c). [14] DSU Art. 26.1 lit. d).
[15] Therefore, the DSU clearly attributes to the Panels and the Appellate Body a role exceeding the typical *assisting* function, despite DSU Art. 11 stating that Panels '*assist* the DSB in discharging its responsibilities under this Understanding and the covered agreements.'

3.1 Recommendations by Panels or the Appellate Body pursuant to DSU Article 19

DSU Article 19 prescribes a three-pronged 'deliverable' of a Panel or Appellate Body report that finds a complaint at least partially well-founded: First, the pertinent dispute settlement organ will conclude that a measure is inconsistent with a covered agreement; as a consequence, it *shall*, secondly, 'recommend that the Member concerned bring the measure into conformity with that agreement'. Thirdly, it *may* suggest *how* to implement that recommendation.[16] The ruling and recommendations of the DSB will—inevitably, pursuant to DSU Articles 16.4 and 17.14—mirror this structure: The DSB *will* conclude that a violation has occurred, *will* request that the member concerned bring the measure into conformity, and, finally, *may* recommend how to implement this.[17]

The first element, i.e. the determination that a breach has occurred, is the conclusion drawn from the 'objective assessment of the matter before' the Panel pursuant to DSU Article 11, both with regards to the facts and the applicable WTO law. The second and third elements are the DSU-specific consequences of the wrongful act (established previously), and are the (only) remedies available to a WTO member, in light of the exclusion (in DSU Article 23) of other avenues to enforce the right of the aggrieved party.

As the purpose of dispute settlement is limited to helping resolve ongoing disputes, a *recommendation* (pursuant to DSU Article 19) to withdraw a measure that is no longer in existence is of no assistance to the resolution of the dispute.[18] Thus, whereas the finding of illegality of a measure that has ceased to exist remains possible, provided 'such finding is necessary to secure a positive solution to the dispute',[19] a recommendation to remedy an illegal measure that has already ended would be both nonsensical and an unjustified intrusion into the right of the concerned state to remain free from unwarranted requests by the DSB.[20]

DSU Article 19.1 leaves no discretion as to the substantive content of the *recommendation*: it will include the holding that the author of the illegal act must change (or abolish altogether) the pertinent measure in order to terminate the violation of WTO law. This obligation does not put into question the member's substantial discretion regarding the specific implementation.[21] The combination of, on the one hand, binding

[16] Article 19 also reflects the obligation of the losing party to comply with its WTO obligations; see Petros C. Mavroidis, 'Article 19 DSU' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Karen Kaiser, eds., *Max Planck Commentaries on World Trade Law: Institutions and Dispute Settlement*, Vol. 2 (Leiden: Martinus Nijhoff Publishers, 2006).

[17] See, for example, *US—Certain EC Products* (Appellate Body), para. 81.

[18] This is not to suggest that a WTO member cannot challenge a measure that has been withdrawn during the adjudication process. WTO adjudicating bodies have consistently held that a legal interest to secure a *ruling* on a withdrawn measure exists to prevent that it may be implemented again in the future. To that effect, see *Chile—Price Band System* (Panel); cf. also *US—Certain EC Products* (Appellate Body), para. 81: 'The Panel erred in recommending that the DSB request the United States to bring into conformity with its WTO obligations a measure which the Panel has found no longer exists.'

[19] *Chile—Price Band System* (Panel), para. 7.112.

[20] See *Dominican Republic—Import and Sale of Cigarettes* (Appellate Body), para. 129.

[21] cf. Petros C. Mavroidis, 'Remedies in the WTO: Between a Rock and a Hard Place' (2000) *European Journal of International Law* 11, 763–813, which emphasizes outer limits to that discretion: for example, the WTO member concerned may not continue or repeat the same behaviour.

determination of a breach, coupled with the ensuing obligation to stop such illegal activity and, on the other hand, a considerable discretion as to *how* to implement a DSB ruling or recommendation may seem counter-intuitive, but represents an important aspect of the WTO's dispute settlement mechanism's calibration:

> The obligation on Members to bring their laws into conformity with WTO obligations is a fundamental feature of the system and, despite the fact that it affects the internal legal system of a State, has to be applied rigorously. At the same time, enforcement of this obligation must be done in the least intrusive way possible. The Member concerned must be allowed the maximum autonomy in ensuring such conformity and, if there is more than one lawful way to achieve this, should have the freedom to choose that way which suits it best.[22]

3.2 Suggestions

DSU Article 19.1 permits Panels and the Appellate Body to go beyond recommending to the DSB that a member stop the internationally wrongful act. Rather, they may also suggest *how* a member can implement its pertinent obligations. Once the pertinent report is adopted, such *suggestions* by the adjudicative bodies will change in status: they will become the (still non-binding) recommendation of the DSB. As such, they serve as (authoritative) guidance as to what should be done.[23] Irrespective of its legal force, a WTO member complying with the DSB recommendation (based on such a *suggestion* pursuant to DSU Article 19), should have achieved compliance with its WTO obligations.[24]

3.2.1 Treatment of requests for suggestions in WTO case law

Whereas the wording of DSU Article 19 suggests that Panels and the Appellate Body are at liberty to make a suggestion if they deem it appropriate in the circumstances,[25] they have exercised that competence very cautiously. This would seem to be motivated by the desire to impede as little as possible members' sovereignty, in order to preserve for them 'the maximum autonomy in ensuring . . . conformity and, if there is more than one lawful way to achieve this, . . . the freedom to choose that way which suits it best.'[26]

Panels and the Appellate Body have—in line with the clear wording of DSU Article 19—adhered to the view that the DSU does not oblige them to suggest a preferred resolution of the dispute, even when requested to do so.[27] In the case *US—Continued*

[22] *US—Section 301 Trade Act* (Panel), para. 7.102.

[23] See, for example, the Appellate Body reports on *EC—Bananas III (Article 21.5—Ecuador)* (Appellate Body), and *EC—Bananas III (Article 21.5—US)*, para. 321.

[24] cf. Mavroidis, 'Remedies in the WTO', n 21 at 781.

[25] In any case, Panels and the Appellate Body are not obliged to issue a suggestion on how to end the stated WTO incompatibility. *US—Steel Plate* (Panel), para. 8.8 and *US—Softwood Lumber V* (Panel), para. 8.6.

[26] *US—Section 301 Trade Act* (Panel), para. 7.102.

[27] A recent illustration of this attitude is traced in the Panel report *EC—Pipe Fittings* (Panel), where the Panel stated at para. 8.11 that: 'By virtue of Article 19.1 of the *DSU*, a panel has discretion to ("may") suggest ways in which a Member could implement the recommendation that the Member concerned bring the measure into conformity with the covered agreement in question. Clearly, however, a panel is by no means

Zeroing, the Appellate Body, after recalling that DSU Article 19.1 *requires* recommendations ('... shall recommend ...'), but merely authorizes suggestions ('... *may* suggest ways in which a Member *could* implement the recommendations ...') stated:

> Therefore, as the right to make a suggestion is discretionary, a panel declining a request for such a suggestion does not act contrary to Article 19 of the DSU.[28]

The discretion on whether making a suggestion is, however, not limitless: In *US—Oil Country Tubular Goods Sunset Reviews (Article 21.5—Argentina)*, the Appellate Body clarified that Panels must give reasons for declining such authority when a party has requested it to do so:

> The discretionary nature of the authority to make a suggestion under Article 19.1 must be kept in mind when examining the sufficiency of a panel's decision not to exercise such authority. However, *it should not relieve a panel from engaging with the arguments put forward by a party in support of such a request.* (Emphasis added.)[29]

At this point, the legal basis for the obligation to engage with a member's request for a suggestion remains unclear; due process considerations and the very purpose of the DSU's mechanism would, however, appear to support that approach.

DSU Article 19 does not require a request by a party as a necessary condition for issuing a *suggestion*.[30] But Panels will discount non-specific requests for suggestions such as the one presented by the European Communities (EC) in *US—Lead and Bismuth II* which suggested 'that the United States amend its countervailing duty laws to recognize the principle that a privatization at market prices extinguishes subsidies.'[31] The Panel declined to make such a broad suggestion and stated instead:

> We would suggest that the United States takes all appropriate steps, including a revision of its administrative practices, to prevent the aforementioned violation of Article 10 of the SCM Agreement from arising in the future.[32]

In *US—Stainless Steel*, the Panel was requested by Korea to suggest that the United States revoke the contested antidumping order. The United States opposed this suggestion and instead asked the Panel to confine itself to a general recommendation.[33] The Panel agreed with the US argument, stating that DSU Article 19.1 'allows but does not require a panel to make a suggestion where it deems it appropriate to do so.'[34] The Panel added that revocation of the antidumping order would be one—but not the only—way for the United States to bring its measures into compliance.[35]

required to make a suggestion should it not deem it appropriate to do so. Thus, while we are free to suggest ways in which we believe the European Communities could appropriately implement our recommendation, we decide not to do so in this case.'

[28] *US—Continued Zeroing* (Appellate Body), para. 389.

[29] *US—Oil Country Tubular Goods Sunset Reviews (Article 21.5—Argentina)* (Appellate Body), para. 183; the Appellate Body left open whether 'Articles 11 and 12.7 were applicable to a request for suggestion'.

[30] See *US—Lead and Bismuth II* (Panel), para. 8.8 and also *US—Softwood Lumber V* (Panel), para. 8.6.

[31] *US—Lead and Bismuth II* (Panel), para. 8.2.

[32] Ibid. para. 8.1.

[33] *US—Stainless Steel (Korea)* (Panel), paras. 3.3 and 3.5.

[34] Ibid. para. 7.8.

[35] Ibid. para. 7.10.

3.2.2 Situations that warrant the issuing of suggestions

Panels will utilize the authorization to suggest pursuant to DSU Article 19 when the discretionary margin of a member as to how to bring its measures in line with WTO law is (exceptionally) reduced to only one option. Thus, in *Guatemala—Cement I*, the complainant (Mexico) requested the Panel to *recommend* that Guatemala revoke the measure and also 'refund those anti-dumping duties already collected'.[36] The Panel declined to make this recommendation, noting that DSU Article 19:1 *obliges* Panels and the Appellate Body to recommend that the member concerned bring measures found to be in violation of WTO obligations into conformity,[37] while it *allows* them to suggest ways in which the member concerned could bring its measure into conformity. But as the Panel had concluded that the entire investigation had been flawed and should never have been initiated, it *suggested* that:

> Guatemala revoke the existing anti-dumping measure on imports of Mexican cement, because, in our view, this is the only appropriate means of implementing our recommendation.[38]

Similarly in *Guatemala—Cement II*, Mexico again requested revocation of duties and reimbursement of the collected duties. After repeating the position that a Panel has discretion to issue suggestions, even where a specific request by a party has been made to this effect,[39] the Panel again noted that the antidumping investigation in question should never have been initiated on the basis of the information submitted by the applicants, that illegalities had been committed during the investigation, and the finding that dumping had occurred (and caused injury) had not been supported by the available evidence. In light of this information, the Panel stated that it could

> not perceive how Guatemala could properly implement our recommendation without revoking the anti-dumping measure at issue in this dispute.[40]

With respect to Mexico's request for *reimbursement* of illegally collected antidumping duties, however, the Panel's analysis was more cautious. It examined the request but ultimately declined to take it up because of 'important systemic issues regarding the nature of the actions necessary to implement a recommendation under Article 19.1. of the DSU'.[41]

[36] *Guatemala—Cement I* (Panel), para. 8.1. [37] Ibid. para. 8.2. [38] Ibid. para. 8.6.

[39] *Guatemala—Cement II* (Panel), para. 9.5 *et seq.*

[40] Ibid. para. 9.6; in *Argentina—Poultry Anti-dumping Duties* (Panel), the Panel found, inter alia, that Argentina's decision to initiate a full antidumping investigation was based on insufficient evidence and, therefore, violated its WTO obligations (para. 8.1(a)(i)). The Panel further found Argentina's WTO violations in that respect 'to be of a fundamental nature and pervasive' (para. 8.6). It concluded in para. 8.7 that '[i]n light of the nature and extent of the violations in this case, we do not perceive how Argentina could properly implement our recommendation without revoking the anti-dumping measure at issue in this dispute. Accordingly, we suggest that Argentina repeal Resolution No. 574/2000 imposing definitive anti-dumping measures on eviscerated poultry from Brazil.' It seems that in the eyes of the Panel, the cumulative and grave nature of the violations suggested that the *only* appropriate remedy was the revocation of the WTO-incompatible Resolution.

[41] *Guatemala—Cement II* (Panel), para. 9.7.

US—1916 Act (Japan) is an exceptional case in which the Panel made a suggestion despite its explicit recognition that several possible corrective actions by the United States were possible. The Panel acceded to a request by Japan to suggest that the United States repeal their WTO-incompatible law. The Panel noted, however, that while it was suggesting repeal, amendment of the offending law may also suffice to correct the violation and that its suggestion should be understood as one of the ways in which the United States could conceivably bring its measures into conformity with its WTO obligations.[42]

3.2.3 Unrequested suggestions

In *EC—Export Subsidies on Sugar*, the Panel made a suggestion without being requested to do so by the complaining party:

> Pursuant to Article 19.1 of the DSU, the Panel suggests that in bringing its exports of sugar into conformity with its obligations . . . , the European Communities consider measures to bring its production of sugar more into line with domestic consumption whilst fully respecting its international commitments with respect to imports, including its commitments to developing countries.[43]

Clearly, the Panel did push the envelope in this case: apparently motivated by the particular concerns and interests of developing countries affected by the EC's measures, it issued a suggestion without request; the suggestion to take certain (probably quite appropriate) policy actions was clearly not mandated by international law. Whereas such an approach might be welcomed and appropriate in a diplomatic dispute settlement environment, it seems questionable whether it is an appropriate course of action in the highly judicialized inter-state dispute settlement mechanism established by the DSU.

4. *Lex specialis* Remedies

Whereas the DSU provides for the generally available declaratory remedies under WTO law, specific remedies are to be found in certain other WTO agreements as *lex specialis*. For example, the Agreement on Subsidies and Countervailing Measures (SCM Agreement) contains important provisions on remedies, notably in the case of prohibited subsidies (Article 4) and actionable subsidies (Article 7).[44] When Article 4.7 of the SCM Agreement specifically defines what a Panel has to do in case of a prohibited (export) subsidy, this, of course, is not a *suggestion* pursuant to the general DSU Article 19.1, but a specific remedy provided for the scenario covered by Article 4.7 of the SCM Agreement.[45]

[42] *US—1916 Act (Japan)* (Panel), para. 6.292.

[43] *EC—Export Subsidies on Sugar* (Panel), para. 8.7.

[44] See the discussion in *US—Upland Cotton (Article 22.6—US)* (Arbitration).

[45] SCM Art. 4.7: 'If a measure is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time period within which the measure must be withdrawn.'

The Appellate Body has clarified that a Panel requested to pronounce on the consistency of a farm subsidy under the disciplines of the Agreement on Agriculture and those of the SCM Agreement, cannot adjudicate the dispute under the former only. In *EC—Export Subsidies on Sugar*, the Appellate Body held this to be a wrong exercise of judicial economy, depriving the complainant of the specific benefit that is the binding request by the DSB to immediately withdraw the subsidies concerned pursuant to Article 4.7 of the SCM Agreement.[46]

5. Prompt Compliance and the Reasonable Period of Time (RPT)

As it may be 'impracticable to comply immediately' with a DSB ruling or recommendation, DSU Article 21.3 allows as a second-best solution compliance within 'a reasonable period' of time.[47] According to the Appellate Body,

> [T]he requirement is immediate compliance. However, Article 21.3 recognizes that immediate compliance may not always be practicable, in which case it foresees the possibility of the implementing Member being given a reasonable period of time to comply. An important consideration is that the reasonable period of time is not determined by the implementing Member itself. Instead, the reasonable period of time may be proposed by the implementing Member and approved by the DSB, mutually agreed by the parties, or determined through binding arbitration. This confirms that the reasonable period of time is a limited exemption from the obligation to comply immediately.[48]

A 'reasonable period of time' (RPT) has been described as 'the shortest period possible within the legal system of the (implementing) Member'.[49] When a reasonable period of time has been granted or agreed upon, compliance with the recommendations and rulings of the DSB must be achieved by the end of the reasonable period of time at the latest.[50] This happens in the vast majority of cases; the important exceptions are more a confirmation of the rule than a negation.[51]

[46] *EC—Export Subsidies on Sugar* (Appellate Body), paras. 334 and 335.

[47] Alberto Alvarez Jimenez, 'A Reasonable Period of Time for Dispute Settlement Implementation: An Operative Interpretation for Developing Country Complainants' (2007) *World Trade Review* 6, 451–76.

[48] *US—Zeroing (Japan) (Article 21.5—Japan)* (Appellate Body), para. 157.

[49] *EC—Hormones (Article 21.3(c))* (Arbitrator), para. 26. But see also the more nuanced Award of the Arbitrator in *United States—Gambling (Article 21.3(c))* (Arbitration), para. 44: '[I]t is useful to recall that the DSU does not refer to the "shortest period possible for implementation within the legal system" of the implementing Member. Rather, this is a convenient phrase that has been used by previous arbitrators to describe their task. I do not, however, view this standard as one that stands in isolation from the text of the DSU. In my view, the determination of the "shortest period possible for implementation" can, and must, also take due account of the two principles that are expressly mentioned in Article 21 of the DSU, namely reasonableness and the need for prompt compliance. Moreover, . . . each arbitrator must take account of "particular circumstances" relevant to the case at hand . . . that are determinative of "reasonableness" in each individual case.'

[50] *US—Zeroing (EC)(Article 21.5—EC)* (Appellate Body), para. 299.

[51] cf. <https://www.wto.org/english/tratop_e/dispu_e/dispu_current_status_e.htm>.

5.1 Bilateral determination of the RPT

In the overwhelming majority of cases,[52] the parties to the dispute reach an agreement as to the length of the RPT:[53] pursuant to DSU Article 21.3(b), parties have forty-five days to come to that agreement. However, state practice has not paid much attention to that time frame.[54] While this seems difficult to reconcile with the wording of Article 21.3(b), the purpose of the DSU (and Article 21 in particular) as well as the member–centric character of the WTO would support a rather generous interpretation to avoid a systemically undesirable obligation to resort to arbitration according to Article 21.3(c) once the forty-five-day timeline of subparagraph (b) has expired.

5.2 Multilateral determination of the RPT

5.2.1 The regulatory framework

DSU Article 21.3(a) and (c) allows the determination of an RPT without *prior* agreement between the parties.

Under subparagraph (a) the implementing member concerned ('Member concerned') may propose to the DSB a suitable period of time. The DSB decision is not subject to 'reverse' consensus, and thus has to be taken by 'positive' consensus (DSU Article 2.4); hence, any member, including the successful complainant, may veto the adoption of the proposal by the DSB. This is a strong incentive to either find an agreed solution or to propose only a solution that seems acceptable for the (successful) complaining member.[55] Not surprisingly, DSU Article 21.3(a) has not been used much.[56]

As a measure of last resort, i.e. if the RPT is not determined pursuant to Article 21.3 (a) and (b), DSU Article 21.3(c) allows—within ninety days after the date of adoption of the recommendations and rulings—binding arbitration to determine what the RPT should be:

> In such arbitration, a guideline for the arbitrator should be that the reasonable period of time to implement panel or Appellate Body recommendations should not exceed

[52] cf. <http://www.worldtradelaw.net/databases/rptawards.php>, where at the time of writing only thirty-one Art. 21.3 (c) awards were reported; to date there have been approximately 200 adopted Panel reports and 117 Appellate Body reports.

[53] The agreed upon periods range from four months and fourteen days to twenty-four months; cf. Peter van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization*, 3rd edn. (Cambridge University Press, 2013) 195.

[54] In *US—Tuna II (Mexico)*, for example, parties needed 96 days to reach an agreement, in *EC—Seal Products* 79 days, and in *China—Rare Earths* 100 days. See also *US—Line Pipe* (Arbitration); *de lege ferenda* see WTO Doc. TN/DS/W/38 (23 January 2003), Dispute Settlement Body—Special Session, Contribution of the European Communities and its Member States to the improvement and clarification of the WTO Dispute Settlement Understanding, where a removal of the deadline is suggested (para. 45).

[55] DSU Art. 2.4, fn. 1. To see this in practice, see *US—Hot-Rolled Steel (Article 21.3)* (Arbitrator) and Dispute Settlement Body, Minutes of the Meeting (WT/DS/M/175), paras. 25–8.

[56] See Werner Zdouc, 'The Reasonable Period of Time for Compliance with Rulings and Recommendations Adopted by the WTO Dispute Settlement Body' in Rufus Yerxa and Bruce Wilson, eds., *Key Issues in WTO Dispute Settlement—The First 10 Years* (Cambridge University Press, 2005) 88, 89.

> 15 months from the date of adoption of a panel or Appellate Body report. However, that time may be shorter or longer, depending upon the particular circumstances.[57]

In most cases submitted to arbitration so far, the Arbitrator has been a member of the Appellate Body. Nevertheless, the time limit of ninety days, of which up to twenty days are reserved for the appointment process, has proven to be an insurmountable hurdle. To exclude the argument that the Arbitrator's mandate had lapsed under those circumstances, parties accept that the award 'would be deemed to be an award under Article 21.3(c) of the DSU',[58] in order to avoid any disputes concerning the validity of the award. Note, that the obligation to implement a DSB ruling starts with the decision to adopt the Panel or Appellate Body report in question; it is then that the RPT (possibly determined later by the Arbitrator) starts, and not at the time of the Article 21.3(c) award.

5.2.2 Determining the RPT through arbitration pursuant to DSB Article 21.3(c)

The task of the Arbitrator—which needs no adoption by the DSB to have legally binding effect, pursuant to DSU Article 21.3(c)—is to determine the 'reasonable period of time' that lies by definition somewhere between (only exceptionally practicable) *immediate compliance* and the desirable (note that the DSU uses the word 'should', rather than 'shall') maximum period of fifteen months from the date of adoption of the Panel or Appellate Body report.[59] In *US—Offset Act (Byrd amendment) (Article 21.3 (c))*,[60] the Arbitrator explained that his mandate did not encompass any suggestion as to the manner in which the concerned party had to implement the decision of the DSB, stating that his task was not 'to look at *how* implementation will be carried out, but to determine *when* it is to be done.'[61]

5.2.2.1 The function of the fifteen-month guideline

In one of the earliest pertinent awards, the Arbitrator in *EC—Hormones* viewed the fifteen-month period pursuant to Article 21.3(c) as 'a guideline for the arbitrator, and not a rule'; in other words, fifteen months is 'the outer limit in the usual case'.[62] This idea has been further refined in later jurisprudence:[63] in *Chile—Price Band System (Article 21.3(c))*,[64] the Arbitrator stated:

[57] DSU Art. 21.3(c).

[58] cf. Statement by the parties in *Chile—Price Band System (Article 21.3)* (Arbitration), para. 2; for a more recent case, see also *Colombia—Ports of Entry (Article 21.3(c))*(Arbitration), para. 6.

[59] DSU Art. 21.3 lit. (c).

[60] *US—Offset Act* (*Byrd amendment) (Article 21.3(c))* (Arbitration).

[61] Ibid. para. 53, emphasis in the original.

[62] *EC—Hormones (Article 21.3)* (Arbitrator), para. 25; see also, Peter Tobias-Stoll and Arthur Steinmann, 'WTO Dispute Settlement: The Implementation Stage' in Jochen A. Frowein and Rüdiger Wolfrum, eds., *Max Planck Yearbook of United Nations Law*, Vol. 3 (Leiden: Martinus Nijhoff Publishers, 1999) 414; as for the average implementation time period, cf. <http://www.worldtradelaw.net/databases/implementaverage.php>.

[63] See also *US—Offset Act (Byrd amendment) (Article 21.3(c))* (Arbitration), para. 25.

[64] *Chile—Price Band System (Article 21.3(c))* (Arbitration).

> Notwithstanding this "guideline" [of a desirable maximum of 15 months from the date of adoption of the panel and Appellate Body reports], I must ultimately be informed, as Article 21.3(c) instructs, by the "particular circumstances" of a given case, which may counsel in favour of shorter or longer periods. As previous arbitrators have observed, the controlling principle is that the "reasonable period of time" should be "the shortest period possible within the legal system of the Member to implement the relevant recommendations and rulings of the DSB", in the light of the 'particular circumstances' of the dispute.[65]

5.2.2.2 The 'particular circumstances'

The reasonableness of the implementation period is to be determined by the particularities of the case. Despite certain criteria having been fleshed out in the pertinent jurisprudence, the strong emphasis on the circumstances of the case entails significant discretion on the part of the Arbitrators:

> [A] 'reasonable period' must be interpreted consistently with the notions of flexibility and balance that are inherent in the concept of 'reasonableness', and in a manner that allows for account to be taken of the particular circumstances of each case.[66]

Despite the recognition that the Arbitrator's task is 'not to look at how implementation will be carried out, but to determine when it is to be done',[67] the jurisprudence now recognizes that the Arbitrator will need to take into account the modalities of possible implementation in determining a reasonable period of time:[68]

> It is generally accepted that an Arbitrator's mandate in these Article 21.3(c) proceedings is limited to determining the 'reasonable period of time' for implementation in the underlying WTO dispute. In fulfilling this limited mandate, the implementing Member has a measure of discretion in selecting the means of implementation that it deems most appropriate. Like previous arbitrators before me, I consider that my mandate relates to the *time* by when the implementing Member must achieve compliance, not to the *manner* in which that Member achieves compliance. Yet, *when* a Member must comply cannot be determined in isolation from the chosen means of implementation. In order 'to determine *when* a Member must comply, it may be necessary to consider *how* a Member proposes to do so.' Thus, in making my determination under Article 21.3(c), the means of implementation available to the Member concerned is a relevant consideration.
>
> While an implementing Member has discretion in selecting the means of implementation, this discretion is not 'an unfettered right to choose any method of implementation'. In my view, implementation of the recommendations and rulings of the DSB in this case is an 'obligation of result', and therefore the means of implementation

[65] Ibid. para. 34.

[66] *US—Hot-Rolled Steel (Article 21.3(c))* (Arbitration).

[67] Ibid. para. 53, emphasis in the original; see also *US—COOL (Article 21.3(c))* (Arbitrator), para. 68 *et seq.*

[68] This proposition was stated quite openly by the Arbitrator in *Brazil—Retreaded Tyres (Article 21.3(c))* (Arbitration), para. 48: 'In my determination, I am also guided by the statements of the arbitrator in *EC—Export Subsidies on Sugar* that "the implementing Member does not have an unfettered right to choose any method of implementation.".'

chosen must be apt in form, nature, and content to effect compliance, and should otherwise be consistent with the covered agreements. Thus, although I am mindful that it falls within the scope of Article 21.5 proceedings to assess whether the measures eventually taken to comply are WTO-consistent, in making my determination under Article 21.3(c) I must consider 'whether the implementing action falls within the range of permissible actions that can be taken in order to implement the DSB's recommendations and rulings.'

As other arbitrators in the past, I also consider that the implementing Member is expected to use whatever flexibility is available within its legal system to promptly implement the recommendations and rulings of the DSB. This is justified by the importance of fulfilling the obligation to comply immediately with the recommendations and rulings of the DSB, which have established that certain measures are inconsistent with a Member's WTO obligations. However, this does not necessarily include recourse to 'extraordinary' procedures.[69]

In line with this discussion, the Arbitrator considered carefully the means proposed by Colombia—the implementing member—and rejected certain proposals which he considered irrelevant to implementation and as unnecessarily prolonging the RPT.[70]

5.2.2.3 Factors considered in WTO arbitral awards

Arbitral Awards consider regularly a number of factors to determine the RPT:[71]

First, the Arbitrator will consider whether compliance requires *legislative* rather than *administrative* means, as the latter requires normally less time.[72] When recourse to legislative activity is required, the possible timeline may be relevant.[73] In the same vein, the legally binding—as opposed to the discretionary—*nature of the implementing procedures* will also weigh in the Arbitrator's mind.[74]

Second, the Arbitrator will consider the *complexity* of the implementation process, such as whether a series of new statutes is required, or whether a simple repeal of the statute suffices.[75] By way of example, in *US—Stainless Steel (Article 21.3(c))*, a case arising under the Anti-Dumping Agreement, the Arbitrator considered the 'technical complexity of eliminating the simple zeroing methodology in periodic reviews due to

[69] *Colombia—Ports of Entry (Article 21.3(c))* (Arbitration), paras. 63–5. See also *US—Stainless Steel (Mexico) (Article 21.3(c))* (Arbitration), paras. 40–3.

[70] The Arbitrator stated, inter alia: 'I am not convinced that a broad reform of numerous provisions of Colombia's Commercial Code concerning customs securities is relevant for my determination, as suggested by Colombia. It may well be the case that Colombia considers it desirable to reform its customs securities statutes in order to ensure that guarantees are effectively available in the context of its revised customs control system. However, the relevant recommendations and rulings of the DSB concern the use of indicative prices for customs valuation purposes and certain restrictions on ports of entry.' *Colombia—Ports of Entry (Article 21.3(c))* (Arbitrator), para. 85.

[71] See Valerie Hughes, 'Arbitration within the WTO' in Federico Ortino and Ernst-Ulrich Petersmann, eds., *The WTO Dispute Settlement System 1995–2003* (The Hague: Kluwer, 2004) 75–86, and Joost Pauwelyn, 'Proposals for Reform of Article 21 of the DSU' in ibid. 51–60.

[72] *Canada—Pharmaceutical Patents (Article 21.3(c))* (Arbitrator), para. 49. See also *Chile—Price Band System (Article 21.3(c))* (Arbitrator), para. 38 (considering pre-legislative activity).

[73] *US—Offset Act (Byrd amendment) (Article 21.3(c))*(Arbitrator), para. 70.

[74] *Canada—Pharmaceutical Patents (Article 21.3(c))* (Arbitrator), para. 51.

[75] Ibid. para. 50.

the import-specific assessment of final anti-dumping liability under the United States' retrospective system'[76] in the following terms:

> Accordingly, the technical complexities of allocation of duties among importers cannot casually be disregarded but, to the contrary, may legitimately be considered a particular circumstance affecting the determination of a reasonable time for abolition of the methodology of simple zeroing in periodic reviews. At the same time, however, this particular circumstance cannot justify a long delay in the implementation of elimination of simple zeroing in periodic reviews. Provisional administrative allocation rules might, perhaps, be devised and put into effect while the long-term administrative or legislative allocation standards are in process of establishment.[77]

Third (and related to the second category), the *role* of the measure found to be inconsistent with WTO rules in a particular society might also influence the definition of RPT. The Arbitrator in *Chile—Price Band System* described this as follows:

> The [measure in question] is so fundamentally integrated into the policies of Chile, that domestic opposition to repeal or modification of those measures reflects, not simply opposition by interest groups to the loss of protection, but also reflects serious debate, within and outside the legislature of Chile, over the means of devising an implementation measure when confronted with a DSB ruling against the original law. In the light of the longstanding nature of the PBS, its fundamental integration into the central agricultural policies of Chile, its price-determinative regulatory position in Chile's agricultural policy, and its intricacy, I find its unique role and impact on Chilean society is a relevant factor in my determination of the "reasonable period of time" for implementation.[78]

Lastly, if the WTO member concerned has *developing country* status, the Arbitrator will, in light of DSU Article 21.2, usually determine a longer RPT.[79] The issue, however, can be more complicated when both defendant and complainant are developing countries. Facing such a dispute, the Arbitrator on *Chile—Price Band System (Article 21.3(c))* decided not to account for this factor in the calculation of the RPT.[80] In *Colombia—Ports of Entry (Article 21.3(c))*, the Arbitrator followed a similar approach:

> [I]n a situation where both the implementing and the complaining Members are developing countries, the requirement provided in Article 21.2 is of little relevance, except if one party succeeds in demonstrating that it is more severely affected by problems related to its developing country status than the other party.[81]

[76] *US—Stainless Steel (Article 21.3(c))* (Arbitrator), para. 59.

[77] Ibid. para. 61.

[78] *Chile—Price Band System (Article 21.3(c))* (Arbitrator), para. 48.

[79] *Chile—Alcoholic Beverages (Article 21.3(c))* (Arbitrator), para. 45; *Indonesia—Autos (Article 21.3(c))* (Arbitrator), para. 24.

[80] 'Accordingly, I recognize that Chile may indeed face obstacles as a developing country in its implementation of the recommendations and rulings of the DSB, and that Argentina, likewise, faces continuing hardship as a developing country so long as the WTO-inconsistent PBS is maintained. In the unusual circumstances of this case, therefore, I am not swayed towards either a longer or shorter period of time by the "[p]articular attention" I pay to the interests of developing countries.' *Chile—Price Band System (Article 21.3(c))* (Arbitrator), para. 56.

[81] *Colombia—Ports of Entry (Article 21.3(c))* (Arbitrator), para. 106.

All the concerns discussed here show that despite the appropriate emphasis on a swift implementation of the ruling, the notion of reasonableness has been used to inject elements of proportionality into the determination of the RPT.

5.2.2.4 Factors not considered in WTO arbitral awards

Factors unrelated to the assessment of the shortest period possible required for implementation do not fall within the ambit of the terms 'particular circumstances' pursuant to Article 21.3.[82] In *US—Offset Act (Byrd amendment) (Article 21.3(c))* the Arbitrator did not consider that the state had to implement an *international* obligation which created additional complexity to the implementation process.[83] Other factors considered irrelevant were, for example, whether or not the executive branch could rely on stable support by the majority of Parliament,[84] the economic and financial consequences resulting from the implementation,[85] and the existence of sufficient further economic harm if implementation was not effected immediately.[86]

5.2.2.5 The burden of proof

Reflecting prior case law,[87] the Arbitrator in *US—Offset Act (Byrd amendment) (Article 21.3(c))* held:

> that it is for the implementing Member to establish that the duration of the implementation period it proposes constitutes the 'shortest period possible' within its legal system to implement the recommendations and rulings of the DSB. Where the implementing Member fails to establish that the period of time requested by it is indeed the shortest period possible within its legal system, the arbitrator must determine the 'shortest period possible' for implementation, which will be shorter than that proposed by the implementing Member, on the basis of the evidence presented by all parties in their submissions, and taking into account the 15-month guideline provided by Article 21.3(c).[88]

Recent jurisprudence has followed this approach with the caveat that the initial burden on the implementing member 'does not absolve the other Member from producing

[82] *Canada—Pharmaceutical Patents (Article 21.3)* (Arbitrator), para. 52.

[83] *US—Offset Act (Byrd amendment) (Article 21.3(c))* (Arbitrator), para. 70. Won-Mog Choi, 'To Comply or Not to Comply?—Non-implementation Problems in the WTO Dispute Settlement System' (2007) *Journal of World Trade* 41, 1043–71; Ngangjoh H. Yenkong, 'World Trade Organization Dispute Settlement Retaliatory Regime at the Tenth Anniversary of the Organization: Reshaping the "Last Resort" Against Non-compliance' (2006) *Journal of World Trade* 40, 365–84; Yuka Fukunaga, 'Securing Compliance through the WTO Dispute Settlement System: Implementation of DSB Recommendations' (2006) *Journal of International Economic Law* 9, 383–426; Bruce Wilson, 'Compliance by WTO Members with Adverse WTO Dispute Settlement Rulings: The Record to Date' (2007) *Journal of International Economic Law* 10, 397–403.

[84] *Japan—Alcoholic Beverages II (Article 21.3 (c))* (Arbitrator), para. 18; *Canada—Patent Term (Article 21.3(c))* (Arbitrator), para. 60.

[85] *Argentina—Hide and Leather (Article 21.3(c))* (Arbitrator), para. 49.

[86] *US—Offset Act (Byrd amendment) (Article 21.3(c))* (Arbitrator), para. 78 *et seq.*; *Canada—Patent Term (Article 21.3(c))* (Arbitrator), para. 48.

[87] *Canada—Pharmaceutical Patents (Article 21.3(c))* (Arbitrator) para. 47; *US—1916 Act*, *(Article 21.3 (c))* (Arbitrator), para. 32.

[88] *US—Offset Act (Byrd amendment) (Article 21.3(c))* (Arbitrator), para. 44.

evidence in support of its contention that the period of time requested by the implementing Member is not "reasonable", and a shorter period of time for implementation is warranted.'[89]

5.3 Surveillance of implementation by the DSB after the establishment of RPT

Under DSU Article 21.6, surveillance of the implementation of adopted recommendations and rulings is the primary responsibility of the DSB; each dispute ('matter') remains on the DSB agenda until the matter is resolved.[90] In addition, the issue of implementation of any adopted ruling may be raised by any member at any time.

6. Compliance Review Pursuant to DSU Article 21.5

6.1 The mechanics

Once the DSB accepts the Panel or Appellate Body finding that a member's measure is not compatible with its obligations under WTO law, it also adopts the recommendations and/or suggestions made pursuant to DSU Article 19.1. This may require the member concerned to modify existing or enact completely new legislation, or, rather, less demanding, to change a particular administrative practice. If these modifications are carried out to the satisfaction of the complaining party, the dispute will have been resolved.

However, in the event that the modifications made do not fully satisfy the complaining party, DSU Article 21.5 provides for ongoing multilateral control of the dispute and excludes unilateral determination of whether the party concerned conformed with the DSB's ruling:

> Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel . . .

The Panel (in the context of Article 21.5 procedures often called a *compliance Panel*) must issue its reports within ninety days; in practice, considerable deviations from this deadline have been common.[91]

[89] *Colombia—Ports of Entry (Article 21.3(c))* (Arbitrator), para. 67.

[90] It is placed on the agenda six months after the date of establishment of RPT (unless the DSB decides otherwise).

[91] cf., for example, the Panel reports in *US—Zeroing (EC) (Article 21.5.—EC)* (Panel), which took a record 449 days from referral of the matter to the Panel; similar long delays may be observed, for example, in *EC—Bananas III (Article 21.5—Ecuador II)* (Panel), and *US—Upland Cotton (Article 21.5—Brazil)* (Panel): the average duration, according to the calculations by <http://www.worldtradelaw.net/databases/suspensionawards.php>, is 257,90 days, thus coming close to 300% of the DSU-allocated time span.

In *US—FSC (Article 21.5—EC II)* the Appellate Body dealt with the specific requirements of a request for the establishment of an Article 21.5 Panel, finding that DSU Article 6.2[92] was 'applicable to panel requests under Article 21.5':

> It is important to note that the text of Article 21.5 expressly links the "measures taken to comply" with the recommendations and rulings of the DSB. Therefore, the "specific measures at issue" to be identified in Article 21.5 proceedings are measures that have a bearing on compliance with the recommendations and rulings of the DSB. This, in our view, indicates that the requirements of Article 6.2 of the DSU, as they apply to an Article 21.5 panel request, must be assessed in the light of the recommendations and rulings of the DSB in the original panel proceedings that dealt with the same dispute. Hence, in order to identify the "specific measures at issue" and to provide "a brief summary of the legal basis of the complaint" in a panel request under Article 21.5, the complaining party must identify, at a *minimum*, the following elements in its panel request. First, the complaining party must cite the recommendations and rulings the DSB made in the original dispute as well as in any preceding Article 21.5 proceedings, which according to the complaining party have not yet been complied with. Secondly, the complaining party must either identify, with sufficient detail, the measures allegedly taken to comply with those recommendations and rulings, as well as any omissions or deficiencies therein, or state that *no* such measures have been taken by the implementing Member. Thirdly, the complaining party must provide a legal basis of its complaint, by specifying how the measures taken, or not taken, fail to remove the WTO-inconsistencies found in the previous proceedings, or whether they have brought about new WTO-inconsistencies.[93] (Emphasis in the original.)

6.2 The rationale for compliance Panels: the exclusion of unilateralism

The rationale for the existence of the compliance mechanism is laid out in DSU Article 23: the drafters of the DSU wanted to mitigate trade disputes by subjecting all decisive steps to multilaterally legitimized and controlled procedures. In the context of compliance it would have been counter-intuitive to subject the dispute as such to strict (multilateral) dispute settlement rules, whereas the determination whether a member had complied with the recommendation and ruling of the DSB would have been left to the parties' (unilateral) determination. It follows that there is no limit to initiating Article 21.5 proceedings. Especially in complex disputes, the parties involved may disagree several times on whether the original wrong has been undone: when this cannot be settled through consultations, either party can bring the matter, as often as deemed necessary, before a compliance Panel.[94]

[92] DSU Art. 6.2 reads: 'The request for the establishment of a panel shall . . . indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. In case the applicant requests the establishment of a panel with other than standard terms of reference, the written request shall include the proposed text of special terms of reference.'

[93] Ibid. paras. 61 and 62.

[94] An example would be *Brazil—Aircraft (Article 21.5—Canada, Second Recourse)* (Panel).

6.3 The mandate of compliance Panels

The mandate of compliance Panels[95] has been clarified by the Appellate Body in its report on *Canada—Aircraft (Article 21.5—Brazil)*[96] which dealt in substance with the question whether the revision of Canada's state aid scheme constituted 'compliance' pursuant to DSU Article 21.1. On appeal, the Appellate Body stated:

> [T]he obligation of the Article 21.5 Panel, in reviewing "consistency" under Article 21.5 of the DSU, was to examine whether the new measure—the revised TPC programme—was "in conformity with", "adhering to the same principles of" or 'compatible with' Article 3.1(a) of the *SCM Agreement*.[97] (Italics in the original.)

According to the Appellate Body, this meant more than the examination of whether the modification measures represented an implementation of the DSB's recommendation of what to do: Rather, it was the duty of the compliance Panel to determine whether the new status quo was compatible with the WTO obligations of the respondent:

> We have already noted that these proceedings, under Article 21.5 of the DSU, concern the "consistency" of the revised TPC programme with Article 3.1(a) of the *SCM Agreement*.[98] Therefore, we disagree with the Article 21.5 Panel that the scope of these Article 21.5 dispute settlement proceedings is limited to "the issue of whether or not Canada *has implemented the DSB recommendation*". The recommendation of the DSB was that the measure found to be a prohibited export subsidy must be withdrawn within 90 days of the adoption of the Appellate Body Report and the original panel report, as modified—that is, by 18 November 1999. That recommendation to "withdraw" the prohibited export subsidy did not, of course, cover the new measure—because the new measure did not exist when the DSB made its recommendation. It follows then that the task of the Article 21.5 Panel in this case is, in fact, to determine whether the new measure—the revised TPC programme—is consistent with Article 3.1(a) of the *SCM Agreement*.
>
> Accordingly, in carrying out its review under Article 21.5 of the DSU, a panel is not confined to examining the "measures taken to comply" from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings. Although these may have some relevance in proceedings under Article 21.5 of the DSU, Article 21.5 proceedings involve, in principle, not the original measure, but rather a new and different measure which was not before the original panel. In addition, the relevant facts bearing upon the "measure taken to comply" may be different from the relevant facts relating to the measure at issue in the original proceedings. It is natural, therefore, that the claims, arguments and factual circumstances which are pertinent to the "measure taken to comply" will not, necessarily, be the same as those which were pertinent in the original dispute. Indeed, the utility of the review envisaged under Article 21.5 of the DSU

[95] See on this matter, but also, in general on the role of Panels, William J. Davey, 'Proposals for Improving the Working Procedures of WTO Dispute Settlement Panels' in Federico Ortino and Ernst-Ulrich Petersmann, eds., *The WTO Dispute Settlement System 1995–2003* (The Hague: Kluwer, 2004) 19–30.

[96] *Canada—Aircraft (Article 21.5—Brazil)* (Appellate Body).

[97] Ibid. para. 37.

[98] Ibid.

> would be seriously undermined if a panel were restricted to examining the new measure from the perspective of the claims, arguments and factual circumstances that related to the original measure, because an Article 21.5 panel would then be unable to examine fully the "consistency with a covered agreement of the measures taken to comply", as required by Article 21.5 of the DSU.[99]

However, the question of whether the measure was one which was taken to comply with the rulings of the DSB and therefore relevant to the Article 21.5 compliance procedure may be disputed and the Appellate Body has favoured a broad interpretation of the phrase 'measures taken to comply.'

> A Member's designation of a measure as one taken "to comply", or not, is relevant to this inquiry, but it cannot be conclusive. Conversely, nor is it up to the complaining Member alone to determine what constitutes the measure taken to comply. It is rather for the Panel itself to determine the ambit of its jurisdiction. . . .
>
> Some measures with a particularly close relationship to the declared "measure taken to comply", and to the recommendations and rulings of the DSB, may also be susceptible to review by a panel acting under Article 21.5. Determining whether this is the case requires a panel to scrutinize these relationships, which may, depending on the particular facts, call for an examination of the timing, nature, and defects of the various measures. This also requires an Article 21.5 panel to examine the factual and legal background against which a declared "measure taken to comply" is adopted. Only then is a panel in a position to take a view as to whether there are sufficiently close links for it to characterize such an other measure as one "taken to comply" and consequently, to assess its consistency with the covered agreements in an Article 21.5 proceeding.[100]

This issue also arose in an interesting fashion in *US—Zeroing (EC) (Article 21.5—EC)* where the United States had taken certain measures in the antidumping context (administrative reviews) *before* the DSB's recommendations and rulings in the case. The Panel reasoned that 'as a matter of logic, . . . a measure taken before the adoption of the DSB's recommendations and rulings could rarely, if ever, be found to be a measure taken "to comply" with such recommendations and rulings.'[101] The Panel, therefore, did not consider these measures to be subject to DSU Article 21.5 proceedings. The Appellate Body disagreed:[102]

> In our view, the Panel's formalistic reliance on the date of issuance of the subsequent review in ascertaining whether these reviews had a close nexus with the recommendations and rulings of the DSB was in error. The relevant inquiry was not whether the subsequent reviews were taken with the intention to comply with the recommendations and rulings of the DSB; rather, in our view, the relevant inquiry was whether the

[99] Ibid. paras. 40–1; similar position in *US—Shrimp (Article 21.5—Malaysia)* (Appellate Body), paras. 85–8. See also *EC—Bed Linen (Article 21.5—India)* (Appellate Body), para. 78 ('If a *claim* challenges a *measure* which is not a "measure taken to comply", that *claim* cannot properly be raised in Article 21.5 proceedings').

[100] *US—Softwood Lumber IV (Article 21.5—Canada)* (Appellate Body), paras. 73, 77.

[101] *US—Zeroing (EC) (Article 21.5—EC)* (Panel), para. 8.115.

[102] *US—Zeroing (EC) (Article 21.5—EC)* (Appellate Body), para. 224.

> subsequent reviews, despite the fact that they were issued before the adoption of the recommendations and rulings of the DSB, still bore a sufficiently close nexus, in terms of *nature*, *effects*, and *timing*, with those recommendations and rulings, and with the declared measures "taken to comply", so as to fall within the scope of Article 21.5 proceedings. (Emphasis in the original).[103]

The Appellate Body has even found that the *measure taken to comply* examined by the compliance Panel may incorporate unaltered elements of the original measure (in this case an arithmetical error) which were not challenged in the original proceedings.

> While claims in Article 21.5 proceedings cannot be used to re-open issues that were decided on substance in the original proceedings, the unconditional acceptance of the recommendations and rulings of the DSB by the parties to a dispute does not preclude raising new claims against measure taken to comply that incorporate unchanged aspects of original measures that could have been made, but were not made, in the original proceedings. We do not see how allowing such claims in Article 21.5 proceedings would "jeopardize the principles of fundamental fairness and due process", or how it would unfairly provide a "second chance" to the complaining Member, provided these new claims relate to a measure "taken to comply" and do not re-argue claims that were decided in the original proceedings.[104]

Whereas it is thus a well-established principle that a complainant can neither use a compliance Panel to renew or expand its challenge to the original measure, the last example shows that Article 21.5 proceedings are indeed new, and comprehensive procedures.[105]

6.4 Appeals of compliance Panel decisions

Although DSU Article 21.5 does not specify that compliance Panel reports may be appealed, multiple cases attest the established practice at the WTO to appeal the report of the compliance Panel to the Appellate Body. According to DSU Article 21.5, disputes over compliance with recommendations and rulings 'shall be decided through recourse to these dispute settlement procedures', which of course are characterized, inter alia, by the option to lodge on appeal.

6.5 The sequencing issue

One of the most discussed topics in the context of the implementation phase is the potential clash between the procedures pursuant to Article 21.5 (examination of compliance), on the one hand, and Article 22.2 (examination whether a request for

[103] Ibid. para. 226. [104] Ibid. para. 427 (footnotes omitted).

[105] *US—Gambling (Article 21.5—Antigua and Barbuda)* (Panel). See for comment on this issue, Fernando Piérola, 'Rearguing a Defence in Implementation Proceedings: Some Thoughts in the Light of the Article 21.5 Panel Report in *United States—Gambling*' (2007) *Global Trade and Customs Journal* 2, 419–20.

enforcement measures is WTO compatible), on the other hand. We discuss this issue after having introduced the reader to the enforcement phase in the next section.

7. Enforcement Measures Pursuant to DSU Article 22

7.1 The remedies available under DSU Article 22.1

Most treaty-based dispute settlement mechanisms do not contain provisions for *enforcing* authoritative dispute settlement decisions. Even when such procedures exist—as was the case in GATT 1947—the decision as to whether enforcement should be activated in a particular case might depend on a political decision by the organs of the pertinent treaty regime. The lack of enforcement was one of the main reasons for the United States to use or threaten to use a unilateral instrument ('Section 301'[106]) to enforce GATT dispute settlement decisions before the establishment of the WTO: While the GATT Contracting Parties did have the competence to take enforcement measures pursuant to GATT Article XXIII, actual enforcement was extremely rare.[107] In the Uruguay Round negotiations, DSU Article 22 was conceived as a form of *multilateralized* 'Section 301' enforcement mechanism: effective enforcement had to be an integral part of the dispute settlement mechanism (hence satisfying the US demands for effectiveness), but only according to multilaterally defined standards and, in the case of disagreement over the legality of enforcement measures, subject to the control by adjudicative bodies set up by the DSU (thus alleviating the fears of American unilateralism). DSU Article 22 thus determines the procedures that apply if the respondent (pursuant to DSU Article 22.2, the 'Member concerned') fails to comply with the DSB's recommendations and rulings. The membership has taken advantage of these possibilities in thirty-six cases.[108]

7.2 The different functions of compensation and suspension of concessions

As a first option, the successful complainant may opt for a buy-out solution: it may request the member concerned (the losing member) to enter into negotiations 'with a view to developing mutually acceptable compensation' (Article 22.2, first sentence). Only if that route is not taken, or, if taken, does not lead to results, the complainant(s) 'may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements' (Article 22.2, second sentence). Therefore, compensation pursuant to DSU Article 22.2 is best understood as a (temporary) re-balancing of the pre-existing balance of rights and

[106] Section 301 of the U.S. Trade Act of 1974 (Pub.L. 93-618, 19 U.S.C. § 2411); see *US—Section 301 Trade Act* (Panel).

[107] See William J. Davey, 'Dispute Settlement in GATT' (1987) *Fordham International Law Journal* 11, 51, 99–103.

[108] cf. <http://www.worldtradelaw.net/databases/retaliationrequests.php.cross>.

obligations. It makes enforcement (temporarily) obsolete, as the complainant, while not receiving its due, gets a (temporary) substitute. Note, that compensation pursuant to DSU Article 22 must not be confused with the notion of compensation in the general law of state responsibility. In general international law, compensation encompasses the undoing of the economic consequences of an internationally wrongful act.[109] In WTO law, it means a (temporary) rebalancing of obligations among certain participants in the multilateral trading system.

In contrast to compensation, the suspension of concessions is inflicted unilaterally upon the member concerned. Despite the difference between compensation, on the one hand, and suspension of concessions or other obligations, on the other, these concepts are conflated in the wording of DSU Article 22.1:

> Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements.

DSU Article 22.1 determines *one* important commonality between the two concepts: both remedies are less than what the complaining member had bargained for, which is specific performance of the commitments undertaken in the WTO Agreement. However, apart from this common trait, the two measures are very different: compensation, while temporary as a matter of principle, may be made permanent if the parties so wish, as no member is obliged to enforce a favourable DSB decision. If the compensation negotiated is a trade concession, nothing in the WTO Agreement prevents such an arrangement, provided that GATT Article I (most-favoured nation treatment) is observed. If the compensation is, rather, a (monthly) payment, say for the development of certain technologies, the latter would arguably not have to be extended to other members pursuant to GATT Article I. Indeed, such a compensation may be a way for the illegally acting member to settle the dispute by re-balancing prospectively (*pro futuro*) the level of reciprocally granted advantages, provided that this rebalancing is compatible with the multilateral trade agreement concerned.[110]

In contrast, *suspension of trade concessions* is an enforcement measure that must be, pursuant to Article 22.8, stopped as soon as the member concerned returns to legality or otherwise terminates the dispute.[111]

[109] cf. Art. 36 of the International Law Commission's Draft Articles on State Responsibility: '1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution. 2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.'

[110] See Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization*, 3rd edn. (Cambridge University Press, 2013) 200, with further references.

[111] Alberto Alvarez Jimenez, 'Mutually Agreed Solutions under the WTO Dispute Settlement Understanding: An Analytical Framework after the Softwood Lumber Arbitration' (2011) *World Trade Review* 10, 343–73.

7.3 Mutually acceptable compensation pursuant to DSU Article 22.2

Recourse to *compensation* has not been frequent; some of the better known examples are listed in the following: In *US—Section 110(5) Copyright Act*,[112] complainant and respondent reached a temporary agreement, running for three years until 20 December 2004, pursuant to which the respondent paid US$ 3.3 million to the complaining member.[113] At the time of writing, the parties are still working in order to reach a mutually satisfactory resolution of this matter.[114] In *US—Upland Cotton*,[115] the United States agreed to fund a $147.3 million per year programme for technical assistance and capacity-building for Brazil's cotton sector.[116] This agreement can be viewed as a temporary financial compensation pending the final resolution of the dispute. In *Japan—Alcoholic Beverages II*,[117] Japan agreed to concede additional market access on certain items, pending the full implementation of the Appellant Body Report.[118]

7.4 Countermeasures: suspension of concessions or other obligations under Article 22

If an agreement on compensation has not been possible, the injured party may ask the DSB for authorization to suspend tariff concessions or other (non-tariff) obligations (DSU Article 22.2). The purpose of this unilateral (but multilaterally legitimized) suspension of obligations from the perspective of the successful complainant is to 'induce compliance'.[119] This request for what are termed 'countermeasures'—made under Article 22.2—calls forth the principles and procedures of Article 22.3.

7.4.1 Countermeasures: cross-retaliation and its limits

The successful complaining party seeking to impose countermeasures must present to the DSB a list of concessions or obligations to be suspended. Pursuant to DSU Article

[112] *US—Section 110(5) Copyright Act* (Panel).

[113] Dispute Settlement Body, Minutes of Meeting, WT/DSB/M/151, 3; *US—Section 110(5) Copyright Act (Article 25 DSU)* (Arbitrator). It should be noted that the amount of compensation had been determined by a DSU Art. 25 arbitration proceeding, which estimated the benefits nullified or impaired to amount to 1.1 million per year. See also the discussion of the case in Gene Grossman and Petros C. Mavroidis, 'Would've or Should've? Impaired Benefits Due to Copyright Infringement' in Henrik Horn and Petros C. Mavroidis, eds., *The WTO Case Law of 2001*, *The American Law Institute Reporters' Studies* (Cambridge University Press, 2003) 281–99. The authors note, inter alia, that it is questionable whether DSU Art. 25 was meant to serve this purpose. It seems that the Arbitrator here assumed a role normally entrusted to an Art. 22.6 DSU arbitration.

[114] *US—Section 110(5) Copyright Act*, Status Report of the United States, WT/DS160/24/Add.123, 9 April 2015.

[115] *United States—Upland Cotton* (Appellate Body).

[116] Randy Schnepf, *Brazil's WTO Case Against the U.S. Cotton Program* (US Congressional Research Service, 7-5700, RL32571, 30 June 2010).

[117] *Japan—Taxes on Alcoholic Beverages* (Appellate Body).

[118] Bryan Mercurio, 'Why Compensation Cannot Replace Trade Retaliation in the WTO Dispute Settlement Understanding' (2009) *Word Trade Review* 8, 315–38, 324.

[119] *EC—Bananas III (US) (Article 22.6—US)* (Arbitrator), para. 6.3.

22.3(a), the first option for countermeasures is to seek suspension in the same sector(s) in which the violation of WTO has been found, i.e.:

(i) with respect to goods, all goods;
(ii) with respect to services, a principal sector as identified in the current "Services Sectoral Classification List" which identifies such sectors;[120]
(iii) with respect to trade-related intellectual property rights, each of the categories of intellectual property rights covered in Section [1-7] of Part II or the obligations under Part III, or Part IV of the Agreement on TRIPS.[121]

However, if such action is not *practicable* or *effective*, the suspension may be applied to a different sector covered by the same agreement[122] (Article 22.3(b)). If this additional escalation is not *practicable or effective*, the complaining party 'may seek to suspend concessions or other obligations under another covered agreement' (Article 22.3(c)). The latter action is known as *cross-retaliation*.[123]

Pursuant to DSU Article 22.3(e), a WTO member wishing to suspend concessions under subsection (b) or (c) of Article 22.3 will have to justify its decision to do so. This obligation became for the first time relevant in *EC—Bananas III*;[124] Ecuador requested authorization to suspend concessions under GATS and TRIPs in order to induce compliance by the EC.[125] As the EC objected to Ecuador's proposal, the matter went to arbitration pursuant to Article 22.6. The ensuing award modified Ecuador's proposal so that *some* of its intended countermeasures ($60.8 million) had to be directed towards goods; the remainder of the trade volume was allowed to affect (up to $201.6 million) services or TRIPs. The Arbitrator in that case set out the standards for applying Article 22.3(b) and (c) as follows:

> It follows from the choice of the words "if that party considers" in subparagraphs (b) and (c) that these subparagraphs leave a certain margin of appreciation to the complaining party concerned in arriving at its conclusions in respect of an evaluation of certain factual elements, i.e. of the practicability and effectiveness of suspension within the same sector or under the same agreement and of the seriousness of circumstances. However, it equally follows from the choice of the words "in considering what concessions or other obligations to suspend, the complaining party shall apply the following principles and procedures" in the chapeau of Article 22.3 that such margin of appreciation by the complaining party concerned is subject to review by the Arbitrators. *In our view, the margin of review by the Arbitrators implies the authority to broadly judge whether the complaining party in question has considered the necessary facts objectively*

[120] Document MTN.GNS/W/120 identifies eleven sectors. [121] DSU Art. 22.3(f).

[122] An *agreement* is, for the purposes of DSU Art. 22.3, the GATT with respect to goods, the GATS with respect to services, and the TRIPs with respect to intellectual property rights, DSU Art. 22.3(g).

[123] Lucas Eduardo and F. A. Spadano, 'Cross-agreement Retaliation in the WTO Dispute Settlement System: An Important Enforcement Mechanism for Developing Countries?' (2008) *World Trade Review*, Vol. 7, 511–45; Frederick Abbott, 'Cross Retaliation in TRIPS: Options for Developing Countries', ICTSD Program on Dispute Settlement and Legal Aspects of International Trade, Florida State University, Spring 2009, available at <http:www.ssrn.com/so13/papers>.

[124] *EC—Bananas III* (Panel and Appellate Body).

[125] *EC—Bananas III*, Recourse by Ecuador to Art. 22.2 of the DSU (WT/DS27/52).

> *and whether, on the basis of these facts, it could plausibly arrive at the conclusion that it was not practicable or effective to seek suspension within the same sector under the same agreements, or only under another agreement provided that the circumstances were serious enough.* ... (Emphasis supplied.)[126]

This standard of review of the complaining party's proposal has been confirmed in subsequent jurisprudence.[127] In *US—Upland Cotton (Article 22.6—US)* the Arbitrators reflected in detail on their understanding of the procedures to be followed by complainants seeking to cross-retaliate and in particular on the meaning of the terms 'practical and effective' of Article 22.3:

> [T]he wording of the provision implies that the complaining party may consider either that it is "not practicable" or that it is "not effective" to seek suspension under the same agreement, and that it need not conclude that same-agreement suspension is both "not practicable" and "not effective", in order to reach the conclusion that it is "not practicable or effective".
>
> *"practicable"*
> ... "[P]racticability" refers to whether suspension in the same sector or agreement is *available for application in practice*, as well as *suited for being used in a particular case*. If it is not a real option or it is not suited to be used in the circumstances, it will be not *practicable*....
>
> In our view, the essence of a consideration of "practicability" of suspension is that it relates to its actual availability and feasibility. The impracticability could be either a legal one, as postulated in the example given in *EC – Bananas III (Ecuador)(Article 22.6 – EC)*, or a factual one, such as might arise if the countermeasure exceeds the total amount of the trade available to be countered.
>
> *"effective"*
> ... The arbitrator on *EC – Bananas III (Ecuador) (Article 22.6 – EC)* ... conclude[d] 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 with DSB rulings within a reasonable period of time"....
>
> We do not share the view ... that a consideration by the complaining party of the sector or agreement in which suspension would be "least harmful" to itself would necessarily be pertinent. As we read the terms of subparagraphs (b) and (c), a consideration of the "effectiveness" criterion under these provisions involves an assessment of the effectiveness—or lack thereof—of suspension *in the same sector or under the same agreement*, rather than an assessment of the relative effectiveness of such suspension, as compared to suspension in another sector or agreement. In other words, the procedures and principles under Article 22.3 do not entitle a complaining party to freely choose *the most* effective sector or agreement under which to seek suspension. Rather, it entitles the complaining party to move out of the same sector or same agreement, where it considers that suspension *in that sector or agreement* is not "practicable or effective".

[126] *EC—Bananas III (Ecuador) (Article 22.6—EC)* (Arbitrator), para. 52.

[127] *US—Gambling (Article 22.6—US)* (Arbitrator), para. 4.18. *US—Upland Cotton (Article 22.6—US I)* (Arbitrator), paras. 5.51 and 5.67.

> . . . [T]he question of whether "the suspension of certain concessions or certain other obligations entails more harmful effects for the party seeking suspension than for the other party" would be pertinent to a consideration of the "effectiveness" of the said suspension. Indeed, as the arbitrator on *EC – Bananas III (Ecuador) (Article 22.6 – EC)* notes, there may be situations in which, for example, the complaining party is heavily dependent on imports from the other party, to such an extent that it may cause more harm to itself than it would to the other party, if it were to suspend concessions or other obligations in relation to these imports. In such a situation, where the complaining party would cause itself disproportionate harm, such that it would in fact be unable to use the authorization, there would be a basis for concluding that such suspension would not be "effective". . . .
>
> This is consistent with the objective of inducing compliance, in that this provision seeks to ensure that the complaining party will be in a position to actually have recourse to the authorized remedy, and thus enable it to contribute to inducing compliance, as is its legitimate purpose. At the same time, we agree . . . that the "likelihood of compliance", as such, is not at issue in this determination. Rather, what is at issue is the ability of the complaining party to make effective use of the awarded countermeasures in order to induce such compliance.[128]

Even when same-agreement suspension is both 'not practicable' and 'not effective', a party cannot just escalate its choice of countermeasures. Rather, the 'circumstances' need to be serious enough for cross-retaliation. Especially relevant are the two factors stated in Article 22.3(d): the importance of the trade in the sector or under the agreement under which nullification or impairment has occurred and the broader economic consequences involved. However, these considerations may not be the only relevant considerations in such an assessment. The statement by the arbitrator on *US—Gambling (Article 22.6—US)* still represents the state of play.

> The determination, which relates to "circumstances", is of necessity an assessment to be made on a case-by-case basis, and that the circumstances that are relevant may vary from case to case. We note however, that these circumstances should be serious "enough", which suggests that it is only when the circumstances reach a certain degree or level of importance, that they can be considered to be serious enough.[128a]

In particular, the 'economic consequences arising from the suspension'[129] need to be taken into account. The twin elements of Article 22.3(d) were also applied by the Arbitrators in *US—Upland Cotton (Article 22.6—US)*, who stated as follows:

> In the circumstances of this case, [Article 22.3(d)(i)] means that what is to be taken into account is "the trade" in all goods under the trade in goods agreement, that is, trade in goods generally, and its importance to Brazil.
>
> The second consideration [Article 22.3(d)(ii)] required to be taken into account is the "broader economic elements related to the nullification or impairment" and the "broader economic consequences of the suspension."

[128] *US—Upland Cotton (Article 22.6—US I)* (Arbitrator), paras. 5.70–5.79, 5.81.
[128a] *US—Gambling (Article 22.6—US)*, para. 4.108.
[129] Ibid. paras. 5.65–5.66, 5.70–5.71, and 5.73, 5.77–5.90.

> [T]he fact that the latter criterion relates to the suspension of concessions or other obligations is not necessarily an indication that "broader economic consequences" relate exclusively to the party which was found not to be in compliance with WTO law, i.e. in this case the European Communities. As noted above, the suspension of concessions may not only affect the party retaliated against, it may also entail, at least to some extent, adverse effects for the complaining party seeking suspension, especially where a great imbalance in terms of trade volumes and economic power exists between the two parties such as in this case where the differences between Ecuador and the European Communities in regard to the size of their economies and the level of socio-economic development are substantial.[130]

7.4.2 Equivalence: the level of permissible countermeasures, DSU Article 22.4

Pursuant to DSU Article 22.4, 'the level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment.' This standard is not dissimilar from the general law on state responsibility, pursuant to which 'countermeasures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and the rights in question'.[131]

According to the Arbitrators in *EC—Banana III (US)* equivalence means:

> "equal in value, significance or meaning", "having the same effect", "having the same relative position or function", "corresponding to", "something equal in value or worth", also "something tantamount or virtually identical". Obviously, this meaning connotes a correspondence, identity or balance between two related levels, i.e. between the level of the concessions to be suspended, on the one hand, and the level of the nullification or impairment, on the other.[132]

At first, this language contrasts somewhat with the more generous notion of 'appropriateness' that is the benchmark for suspensions of concessions under GATT Article XXIII:2. However,

> in light of the explicit reference in paragraphs 4 and 7 of Article 22 of the DSU to the need to ensure the *equivalence* between the level of proposed suspension and the level of the nullification or impairment suffered, the standard of *appropriateness*... has lost its significance as a benchmark for the authorization of the suspension of concessions under the DSU.... [T]he ordinary meaning of "*appropriate*", connoting "specially suitable, proper, fitting, attached or belonging to", suggests a certain degree of relation between the level of the proposed suspension and the level of nullification or impairment, where as we stated above, the ordinary meaning of "*equivalent*" implies a higher

[130] Ibid.

[131] UN Doc. A/RES/56/83, General Assembly, Resolution adopted by the General Assembly [on the report of the Sixth Committee (A/56/589 and Corr.1)] 56/83, Responsibility of States for internationally wrongful acts, Art. 51 of the Draft Articles.

[132] *EC—Bananas III (US) (Article 22.6—EC)* (Arbitrator), para. 4.1.

> degree of correspondence, identity or stricter balance between the level of the proposed suspension and the level of nullification or impairment.[133]

This convincing reading of DSU Article 22.4 excludes a priori any punitive consideration: that notion, it will be recalled, is alien to the concept of both general countermeasures and enforcement measures under the DSU.[134]

Nevertheless, the decision in *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* is noteworthy.[135] Without referring to any punitive function, the Arbitrators increased the countermeasures by adding a 20 per cent mark-up simply because Canada had officially stated that it would maintain its subsidy programme irrespective of the Arbitrators' decision:

> Recalling Canada's current position to maintain the subsidy at issue and having regard to the role of countermeasures in inducing compliance, we have decided to adjust the level of countermeasures calculated on the basis of the total amount of the subsidy by an amount which we deem reasonably meaningful to cause Canada to reconsider its current position to maintain the subsidy at issue in breach of its obligations. We consequently adjust the level of countermeasures by an amount corresponding to 20 per cent of the amount of the subsidy...[136]

In *US—1916 Act (EC)*,[137] a US statute had been ruled to be WTO-inconsistent; but the United States failed to comply pursuant to DSU Article 21.1. However, the European Community—in the absence of an agreement with the United States—submitted a proposal to adopt *mirror legislation*,[138] aiming at making its trading partner swallow some of the medicine it dispenses to others.

While the Arbitrators allowed the suspension of concessions equivalent to the amount of nullification and impairment caused by the WTO-incompatible US measure, they viewed the proposed enforcement measures as incompatible with the equivalence requirement in DSU Article 22.4:

> Thus, we are of the view that the European Communities' proposal to adopt a "mirror" regulation relates to the nature of the obligations to be suspended. We agree with the United States that we do not have the jurisdiction to determine equivalence between the *measure* proposed to implement the suspension and the *measure* that resulted in the nullification or impairment. DSU Article 22.6 and 22.7 authorize the suspension of *concessions or other obligations*. The arbitrators do not have the jurisdiction to approve the adoption of *measures* by the complaining party.[139]

[133] Ibid. paras. 6.4–6.5. [134] *EC—Bananas III (Ecuador) (Article 22.6—EC)* (Arbitrator), para. 6.3.

[135] *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* (Arbitrator).

[136] Ibid. para. 3.121. [137] *US—1916 Act (EC) (Article 22.6 (US))* (Arbitrator), para. 5.42.

[138] For a critical view of mirror trade measures see Alan W. Wolff, 'Remedy in WTO Dispute Settlement' in Merit E. Janow, Victoria Donaldson, and Alan Yanovich, eds., *The WTO: Governance, Dispute Settlement & Developing Countries* (New York: Juris Publishing Inc., 2008) 797.

[139] The Arbitrators declined the EC request arguing that it was impossible for them to accept it since there was no way they could ensure equivalence between the nullification suffered by either side (as a result of the original violation for the EC and the countermeasures for the United States), as required by DSU Art. 22.4. They did open the way, however, for the EC to impose countermeasures in the future to recover monetary amounts paid pursuant to final judgments in the United States or pursuant to settlements.

7.5 Prospective or retroactive remedies

Equivalence between countermeasure and original treaty violation must be demonstrated when a request for authorization to suspend concessions is being submitted. As WTO law stands, the calculation must not include past damages to the complainant's trade interests, but rather must be limited to the (unfavourable) difference between the trade benefits resulting from abiding by the WTO obligations and the status quo which is shaped by the continuing breach of WTO law. In their report on *EC—Hormones (US) (Article 22.6—EC)*, the Arbitrators therefore decided that the pertinent countermeasures should be calculated from the end of the RPT.[140] Similar conclusions are to be found, for example, in *EC—Bananas III (Ecuador) (Article 22.6—EC)*,[141] as well as the report on *Brazil—Aircraft (Article 22.6—Brazil)*.[142]

However, the Panel in *Australia—Automotive Leather II* reached a different conclusion with regard to the *lex specialis* of SCM Article 4.7:

> [W]e do not believe that Article 19(1) of the DSU, even in conjunction with Article 3 (7) of the DSU, requires the limitation of the specific remedy provided for in Article 4 (7) of the SCM Agreement to purely prospective action.[143]

Retroactive remedies are not unheard of in the AD/CVD practice of the GATT/WTO regime: in the GATT era, there were five reported cases where GATT contracting parties recommended that GATT parties which illegally imposed antidumping or countervailing duties should *reimburse* all duties illegally perceived from the date of the first perception of such duties.[144] However, the general view remains that WTO remedies cannot be applied retroactively.[145] Furthermore, the *Australia—Automotive Leather II* case concerned prohibited export subsidies and should be distinguished *de lege lata*; this is not to say, however, that it would not be worth exploring how to create a stronger incentive to comply with recommendations and rulings which would still be acceptable to WTO members. For instance, it would be imaginable to allow a right to compensate calculated on the basis of the nullification and impairment from the date of the establishment of the first Panel in the original proceedings or the decision of the DBS or some other well-defined point in time, thus avoiding unacceptable compensation claims.

[140] *EC—Hormones (US) (Article 22.6—EC)* (Arbitrator), para. 38.

[141] *EC—Bananas III (Ecuador) (Article 22.6—EC)* (Arbitrator).

[142] *Brazil—Aircraft (Article 22.6—Brazil)* (Arbitrator).

[143] *Australia—Automotive Leather II (Article 21.5)* (Panel), para. 6.31.

[144] All GATT cases are reported in Ernst-Ulrich Petersmann, 'International Competition Rules for the GATT/WTO World Trade and Legal System' (1993) *Journal of World Trade* 35, 27–67 and Mavroidis, 'Remedies in the WTO', n. 21 at 763–813.

[145] The US view, reported in *Guatemala—Cement I* (Panel), para. 5.63, represents the membership's view: '[R]etroactive remedies are inconsistent with the established practice of panels refraining from recommending remedies that attempt somehow to restore the status quo ante or otherwise compensate the prevailing party for WTO-inconsistent actions taken by the defending party'; further examples of state practice reported by Frieder Roessler, 'The Responsibilities of a WTO Member Found to Have Violated WTO Law' in *The WTO in the Twenty-first Century—Dispute Settlement, Negotiations and Regionalism in Asia*, edited by Yasuhei Taniguchi, Alan Yanovich, and Jan Bohanes (Cambridge University Press, 2007) 141, 142.

Prospective remedies mean, as a practical matter, that less trade is affected by countermeasures. This is both an advantage and a weakness: since the consequences are not as harsh, such remedies might be less efficient in inducing compliance. For example, the member violating the Antidumping Agreement knows that in the worst case scenario, it may be ordered to end, after years of effective protectionist trade impeding measures, its WTO-inconsistent duties. However, the goal of the WTO is to facilitate trade, not impede it: countermeasures multiply the amount of trade that is subjected to treatment that is not desirable from the perspective of WTO law. Stronger defences therefore do have the downside of futher destabilizing international trade. On the other hand, initiatives aiming at clarifying this issue amongst WTO members have not been translated into treaty modifications. As things stand, 'retroactive remedies are alien to the long established GATT/WTO practice where remedies have traditionally been prospective',[146] save some exceptions particularly in the field of AD and CVD laws.[147]

7.6 Compulsory submission to arbitration (Article 22.6)

The request by a WTO member to cross-retaliate is fully *justiciable*: If the member concerned objects to the proposed countermeasures as not conforming with DSU Article 22.3, 22.4, or 22.5, or on other grounds, the matter will be referred to arbitration under DSU Article 22.6., 22.7. If possible, the members of the original Panel will serve as Arbitrators; otherwise, the Director-General of the WTO will appoint substitute arbitrators. So far, nineteen arbitral awards under DSU Article 22.6 have been rendered.[148]

7.6.1 The mandate of the Arbitrators

DSU Article 22.7 requests the Arbitrators to ensure that the level of proposed countermeasures does not surpass the prospective nullification and impairment suffered by the party requesting authorization to adopt countermeasures.[149] Summarizing past practice in this respect, the Arbitrators in *US—Gambling (Article 22.6—US)*[150] defined their task in the context of DSU Article 22.6 as an obligation to determine, in the light of DSU Article 22.3 and 22.4, the correct volume of allowable countermeasures.

7.6.2 The burden of proof

The burden of proof in Article 22.6 arbitrations, as in regular WTO dispute settlement, is well established:

146 *US—Certain EC Products* (Panel), para. 6.106. 147 cf. Art. 4.7 of the SCM Agreement.

148 cf. <http://www.worldtradelaw.net/databases/suspensionawards.php>.

149 To perform their task, the Arbitrators will adopt their own working procedures. See, for example, the procedures described in an Annex to the *US Offset Act (Byrd amendment) (EC) (Article 22.6—US)*, Decision by the Arbitrator (WT/DS217/ARB/EEC), 31 August 2004.

150 *US—Gambling (Article 22.6—US)* (Arbitrator), paras. 2.5–2.9.

> WTO Members, as sovereign entities, can be *presumed* to act in conformity with their WTO obligations. A party claiming that a Member has acted *inconsistently* with WTO rules bears the burden of proving that inconsistency. The act at issue here is the US proposal to suspend concessions. The WTO rule in question is Article 22.4 prescribing that the level of suspension be equivalent to the level of nullification and impairment. The EC challenges the conformity of the US proposal with the said WTO rule. It is thus for the EC to prove that the US proposal is inconsistent with Article 22.4. Following well-established WTO jurisprudence, this means that it is for the EC to submit arguments and evidence sufficient to establish a *prima facie* case or presumption that the level of suspension proposed by the US is *not* equivalent to the level of nullification and impairment caused by the EC hormone ban. Once the EC has done so, however, it is for the US to submit arguments and evidence sufficient to rebut that presumption. Should all arguments and evidence remain in equipoise, the EC, as the party bearing the original burden of proof, would lose.
>
> The same rules apply where the existence of a specific *fact* is alleged . . .
>
> The duty that rests on *all* parties to produce evidence and to collaborate in presenting evidence to the arbitrators—an issue to be distinguished from the question of who bears the burden of proof—is crucial in Article 22 arbitration proceedings. The EC is required to submit evidence showing that the proposal is *not* equivalent. However, at the same time and as soon as it can, the US is required to come forward with evidence explaining how it arrived at its proposal and showing why its proposal *is* equivalent to the trade impairment it has suffered . . . (Emphasis and italics in the original.)[151]

The Arbitrators reiterated this allocation of the burden of proof in arbitration proceedings under DSU Article 22.6 in the *US—Gambling*[152] and in the *US—Upland Cotton* arbitrations.[153] Hence, there is a presumption in favour of the proposed suspension unless it is challenged effectively by the other party.

7.6.3 The Arbitrators' decision: first and last resort

DSU Article 22.7 pertinently provides that the parties to the dispute shall accept the Arbitrators' decision as final, hence precluding the possibility to appeal the Arbitrators' award.[154] DSU Article 22.7 also provides for adoption of the Arbitrators' report by the DSB. The DSB must be informed of the report 'promptly' and will, upon request, grant the authorization for the prescribed remedies in the Arbitrators' report, 'unless the DSB decides by consensus to reject the request'.

7.6.4 Calculating the level of suspension of concessions

Calculating the level of suspension of concessions has been one of the rare constellations where WTO adjudicating bodies have had recourse to institutional (WTO) economics expertise: whereas it is normally the Legal Affairs Division and the Rules

[151] *EC—Hormones (US) (Article 22.6—EC)* (Arbitrator), paras. 9–11.

[152] Ibid. paras. 2.21–2.23.

[153] *US—Upland Cotton (Article 22.6—US I)* (Arbitrator), paras. 4.21–4.23; *US—Upland Cotton (Article 22.6—US II)* (Arbitrator), paras. 4 and 12–14. See also *US—1916 Act (EC) (Article 22.6—US)* (Arbitrator).

[154] *EC—Bananas III (Ecuador) (Article 22.6—EC)* (Arbitrator), para. II.3.

Division of the WTO Secretariat that assists Panels, Arbitrators draw on the expertise provided by the Economics Division to determine a figure in the context of a DSU Article 22.6 review.[155] Typically, the Arbitrator will determine the appropriate level of countermeasures at a significantly lower level than requested by the party wishing to enforce its rights.[156] A good example is the decision on *US Offset Act (Byrd Amendment) (EC) (Article 22.6—US)*.[157] This statute allowed the US administration to impose duties on products from all and any trading partners. The Arbitrators' task, however, was to define the level of countermeasures that the European Community could impose. To complicate matters further, some subsequent duty modifications by the US Act could be expected to have beneficial consequences for the EC: imposition of duties on Japanese and Korean computers would have rendered like EC products more competitive in the US market.

The Arbitrators decided that the European Community could impose countermeasures not exceeding 72 per cent of all 'anti-dumping or countervailing duties paid on imports from the European Communities at that time, as published by the United States' authorities duties imposed by the United States on imports originating in the European Community'.[158] To reach this conclusion, the Arbitrators had to consider divergent econometric models submitted by the two parties. Whereas the decision follows a modified version of the model proposed by the requesting parties,[159] the Arbitrators emphasized that the task of evaluating the trade effects of the scheme could not be accomplished with mathematical precision.[160]

7.6.5 Indirect benefits: what counts as a nullified or impaired benefit?

What counts as a nullified or impaired benefit? In *EC—Bananas III (Ecuador) (Article 22.6—EC)*,[161] the United States claimed that the calculation of the countermeasure should take into consideration the lost profits that were the consequence of the EC's WTO-incompatible banana regime. In their view, the European Community, by blocking banana imports from Mexico, was influencing adversely exports of US fertilizers to Mexico. The Arbitrators refused to follow that argumentation:

> We are of the view that the benchmark for the calculation of nullification or impairment of US trade flows should be losses in US exports of goods to the European Communities and losses by US service suppliers in services supply in or to the European Communities. However, we are of the opinion that losses of US exports in goods or services between the US and third countries do not constitute nullification or impairment of even *indirect* benefits accruing to the United States under the GATT

[155] See Alexander Keck, 'WTO Dispute Settlement: What Role for Economic Analysis?' (2004) *Journal of Industry, Competition and Trade* 4, 365.

[156] The prototypical example for this statement is *US—Gambling*: there, the Arbitrator authorized 21 Mio. USD per year, whereas suspension worth almost 3.5 billion USD had been requested.

[157] *US—Offset Act (Byrd Amendment) (EC) (Article 22.6—US)* (Arbitrator).

[158] Ibid. paras. 5.1–5.4.

[159] Ibid. paras. 3.105–3.151.

[160] Ibid. para. 3.148–3.151. For another economic analysis used to calculate countermeasures, compare *US—FSC (Article 22.6—US)* (Arbitrator).

[161] *EC—Bananas III (Ecuador) (Article 22.6—EC)* (Arbitrator).

or the GATS for which the European Communities could face suspension of concessions. To the extent the US assessment of nullification or impairment includes lost US exports defined as US content incorporated in Latin American bananas (e.g. US fertilizer, pesticides and machinery shipped to *Latin America and US capital or management service*s used in banana cultivation), we do not consider such lost US exports for calculating nullification or impairment in the present arbitration proceeding between the European Communities and the United States.

…It would be wrong to assume that there is no further recourse within the framework of the WTO dispute settlement system to claim compensation or to request authorization to suspend concessions equivalent to the level of the nullification or impairment caused with respect to bananas of Latin American origin, including incorporated inputs of whatever kind or origin. A right to seek redress for that amount of nullification or impairment does exist under the DSU for the WTO Members which are the countries of origin for these bananas, but not for the United States.… [T]here is no right and no need under the DSU for one WTO Member to claim compensation or request authorization to suspend concessions for the nullification or impairment suffered by another WTO Member with respect to goods bearing the latter's origin or service suppliers owned or controlled by it.[162] (Emphasis in the original.)

Trade is so intertwined across countries that opening the door to *indirect benefits* amounts to a quasi-impossibility to drawing a predictable line. Legal predictability and security, it will be recalled, is one of the most important benefits of the GATT/WTO system, and clearly would be endangered by such an approach.

The above discussion on indirect benefits informs the calculation of the level of nullification and impairment: the Arbitrators only include the value added in a given member state to determine this member's nullification and impairment. To give an example: an item produced in member M has a value of €10. For the production of that item, the producer MP uses imported materials worth €4. Whereas MP will lose €10/unit in the case where an illegal trade barrier has been erected against products from M, it will stop importing the input worth €4. As a result, M's actual nullification and impairment will not be 10, but €6/unit. To proceed otherwise would lead to a double-counting that would not be compatible

with the standard of "equivalence" as embodied in paragraphs 4 and 7 of Article 22 of the DSU […]. Given that the same amount of nullification or impairment inflicted on one Member cannot simultaneously be inflicted on another, the authorizations to suspend concessions granted by the DSB to different WTO Members could exceed the overall amount of nullification or impairment caused by the Member that has failed to bring a WTO-inconsistent measure into compliance with WTO law. Moreover, such cumulative compensation or cumulative suspension of concessions by different WTO Members for the same amount of nullification or impairment would run counter to the general international law principle of proportionality of countermeasures.

We consider that not only goods or service inputs in banana cultivation but also services that add value to bananas after harvesting up to the f.o.b. stage should be

[162] Ibid. paras. 6.12 and 6.14.

> excluded from the calculation of nullification or impairment that the United States is entitled to claim in the present arbitration proceeding. We realize that the use of this f.o.b. cut-off point as well as of origin rules is somewhat arbitrary. The globalization of the world economy means that products increasingly "incorporate" as intermediate inputs many goods and services of different origins. While it may be necessary to develop more sophisticated rules in this regard in the future, we believe that the line we have drawn is appropriate in this particular case, which involves the suspension of concessions. We imply no limitations on the extent of WTO obligations for this or other cases by this decision.[163]

7.6.6 Litigation costs are not recoverable

Because only the nullification and impairment of (future) trade benefits and not the compensation for (past) damages or other disadvantageous consequences of WTO-incompatible measures determine the extent of possible countermeasures, the legal fees paid may not be included in the calculation of nullification and impairment, as there is no 'basis in the WTO Agreements to support the view . . . that legal fees can be claimed as a loss of a benefit accruing to a WTO Member.'[164]

7.6.7 The special cases of prohibited and actionable subsidies

Arbitrations involving prohibited or actionable subsidies under the SCM Agreement involve special considerations that are somewhat different from other Article 22.6 arbitrations.

This is exemplified by the *US—Upland Cotton* Article 22.6 arbitration decisions which were handed down after the United States had been found to be maintaining prohibited and actionable agricultural subsidies by both the Panel and the Appellate Body[165] (and after both of these bodies sitting as Article 21.5 compliance Panels[166] found that the United States had not sufficiently corrected the WTO violations involved). Two separate arbitrations (before the same Arbitrators) were undertaken—one under Article 22.6 as well as SCM Article 4.11 to determine the appropriate amount for suspensions in response to (maintaining) a prohibited subsidy; and the second under Article 22.6 and SCM Article 7.10 to determine the remedy for maintaining an actionable subsidy. In both proceedings, the Arbitrators ruled that both the provisions of the DSU as well as the SCM Agreement applied and that the SCM Agreement as *lex specialis* ought to play a dominant role.[167]

The Arbitrators first determined the meaning of 'appropriate' countermeasures, the remedy for prohibited subsidies, drawing guidance from footnote 9 to the SCM Agreement, which states that the term 'appropriate' means essentially not 'disproportionate'.

[163] *EC—Bananas III (Ecuador) (Article 22.6—EC)* (Arbitrator), paras. 6.16 and 6.18.
[164] *US—1916 Act (EC) (Article 22.6—US)* (Arbitrator), para. 5.76.
[165] *US—Upland Cotton* (Panel and Appellate Body).
[166] *US—Upland Cotton (Article 21.5—Brazil)* (Panel and Appellate Body).
[167] *US—Upland Cotton (Article 22.6—US)* (Arbitrator) paras. 5.27–5.32; 5.50–5.51.

The Arbitrators also noted that in prior prohibited subsidy remedy arbitrations, most notably in *Brazil—Aircraft (Article 22.6—Brazil)*,[168] the level of the subsidy paid by Brazil to its aircraft producers was used as the benchmark for countermeasures. This approach was followed in two other Article 22.6 arbitrations, which equally calculated the permissible amount of countermeasures based on the amount of the subsidy.[169] While not discounting this approach applied by prior Panels, the Arbitrators ruled that the remedial focus should be on the injury rather than the subsidy:

> The use of the "amount of the subsidy" in prior cases does not imply, however, that the arbitrators in these earlier cases necessarily considered that the "amount of the subsidy" was the only basis on which "appropriate countermeasures" might have been calculated. In fact, as we understand it, the arbitrators in these cases took into account the fact that the legal standard embodied in Article 4.10 of the SCM Agreement allows greater flexibility than those under Article 22.4 of the DSU or Article 7.9 of the SCM Agreement to tailor the countermeasures to the specific circumstances of the case at hand ... In fact, in these decisions, some form of consideration was given to the trade effects of the measure on the complaining Member. ...
>
> As we have determined above, a consideration of the "appropriateness" of countermeasures, and in particular the requirement for the countermeasures not to be "disproportionate", suggests that there should be a degree of relationship between the level of countermeasures and the trade-distorting impact of the measure on the complaining Member.
>
> In most cases, the trade-distorting impact of the subsidy on one or several other Members would not necessarily bear any particular relationship to the amount of the subsidy. ... [T]he amount of the subsidy may in fact be lower than its trade effects, and apportioning it would ordinarily exacerbate that likelihood. This amount therefore does not seem to us to be *a priori* appropriate, nor is it necessarily proportionate to the extent to which the trade of the Member concerned is adversely affected. In these circumstances, it cannot be assumed that the total amount of the subsidy is an appropriate measure of its trade effects, or even that it is necessarily a relevant "proxy" for those effects.[170]

The Arbitrators determined that consideration of the trade-distorting impact of the US subsidies to be the appropriate criteria for calculation of countermeasures despite both parties' arguments that the appropriate countermeasure should be based on the amount of the subsidy. Interestingly, in spite of the divergent approaches adopted by the parties on the one hand and the Arbitrators on the other, the decision nonetheless used the figures proposed by the parties:

> (I)t seems to us that, while purporting to apply an approach based primarily on the "amount of the subsidy", both parties have in fact incorporated in their analysis elements that aim to capture the trade effects of the measure, rather than its "amount". ...

[168] *Brazil—Aircraft (Article 22.6—Brazil)* (Arbitrator).
[169] *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* (Arbitrator); *US—FSC (Article 22.6—US)* (Arbitrator).
[170] *US—Upland Cotton (Article 22.6—US)* (Arbitrator), paras. 4.133, 4.135, 4.136.

> . . . This confirms us in our view that there is no particular basis for assuming, *a priori*, that the amount of the subsidy alone adequately reflects the relevant circumstances, for the purposes of calculating "appropriate" countermeasures.[171]

An additional argument in favour of this more holistic approach are the difficulties that may arise, when another WTO member successfully challenges the original measure of a respondent member and requests authorization to adopt countermeasures against that very member.[172]

> Had there been multiple complainants each seeking to take countermeasures in an amount equal to the value of the subsidy, this would certainly have been a consideration to take into account in evaluating whether such countermeasures might be considered to be not "appropriate" in the circumstances. . . . On any hypothesis that there would be a future complainant, we can only observe that this would give rise inevitably to a different situation for assessment. To the extent that the basis sought for countermeasures was purely and simply that of countering the initial measure (as opposed to, e.g., the trade effects on the Member concerned) it is conceivable that the allocation issue would arise.[173]

Thus, the new standard for an 'appropriate' remedy for prohibited subsidies announced by the *US—Upland Cotton* Arbitrators appears welcome.

As to the remedy for actionable subsidies under SCM Article 7.10, the Arbitrators interpreted 'commensurate' to mean a correspondence between the countermeasures and the 'degree and nature of the adverse effects determined to exist.'[174] To apply this standard the Arbitrators used economic modelling to calculate the worldwide impact of the US subsidies and the amount of adverse effects that should be apportioned to Brazil.[175]

8. Compliance Following the Adoption of Countermeasures

The DSU contains no specific provisions concerning the case where countermeasures have been authorized and, after the imposition of countermeasures, the member on the receiving end takes corrective action to come into compliance with its WTO obligations. Such a situation poses no difficulty, if the member(s) imposing the countermeasures agrees that the once prodigal member is now in compliance. But what happens when there is disagreement on this point—when the member subjected to countermeasures claims to be in compliance, whereas the member(s) imposing the countermeasures has the opposite view?

This precise question came up in the *Canada—Continued Suspension (Hormones)* case, which was decided by the Appellate Body in 2008. In this dispute, the AppellateBody had ruled (in 1998!) that the EC's trade restrictions on hormone-treated meat violated several WTO rules; as a consequence, both Canada and the United States had obtained

[171] *US—Upland Cotton (Article 22.6—US)* (Arbitrator), paras. 4.170 and 4.171.
[172] *US—Upland Cotton (Article 22.6—US)* (Arbitrator), paras. 4.170 and 4.171.
[173] *US—FSC (Article 22.6—US)* (Arbitrator), paras. 4.170 and 4.171.
[174] *US—Upland Cotton (Article 22.6—US)* (Arbitrator), para. 4.35.
[175] *US—Upland Cotton (Article 22.6—US)* (Arbitrator), paras. 4.193–4.195.

authorization to impose countermeasures in 1999. In 2003, the EC amended its Directive on hormone-treated meat and notified the DSB that it had complied with the 'recommendations and rulings' of the DSB in the original case. Canada and the United States, however, refused to end their countermeasures, as they viewed the EC's action as insufficient. The EC then initiated proceedings against both Canada and the United States in 2004, claiming that both countries violated WTO rules by continuing the suspension of concessions without further authorization by the DSB.

In the *Canada—Continued Suspension (Hormones)* case, the substance of which we treat in Chapter 20 on environmental protection and trade, the Appellate Body set out guidance for how members should handle the case in which countermeasures are in effect, but the member on the receiving end has taken corrective, albeit possibly insufficient, action:

> Where, as in this dispute, an implementing measure is taken and Members disagree as to whether this measure achieves substantive compliance, both Members have a duty to engage in WTO dispute settlement in order to establish whether the conditions in Article 22.8 have been met and whether, as a consequence, the suspension of concessions must be terminated . . .
>
> Article 21.5 does not indicate which party may initiate proceedings under this provision. Rather, the language of the provision is neutral on this matter, and it is open to either party to refer the matter to an Article 21.5 panel. . . . Thus . . . the text of Article 21.5 does not preclude an original respondent from initiating proceedings under that provision to obtain confirmation of the consistency with the WTO agreements of its implementing measure.[176]

The *Canada—Suspension* decision, therefore, laid this issue to rest, which had been the consequence of the DSU's drafters oversight.

9. The Sequencing Issue: DSU Article 21.5 vs. 22.2

The relationship between the procedures established by DSU Articles 21.5 and 22.2 has given rise to a significant amount of scholarly writing and adjudicative practice. Which of the two procedures has priority, if at all? Must compliance be asserted via Article 21.5 before a party can move to request authorization for the enforcement of its rights (as confirmed by the successful violation complaint)? Whereas DSU Article 21.5 provides that:

> [w]here there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel [,]

DSU Article 22.2 determines that:

> [i]f the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the

[176] *Canada—Continued Suspension* (Appellate Body), paras. 310, 347.

> recommendations and rulings within the reasonable period of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation. If no satisfactory compensation has been agreed within 20 days after the date of expiry of the reasonable period of time, any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.

Despite the lack of any language in DSU Article 22.2 requiring a previous 'certificate of non-compliance' (pursuant to DSU Article 21.5), one would, at first sight, be inclined to request that a member seeking enforcement would achieve clarity as to whether non-compliance exists. Such a view would seem to fit best with the structure of the provisions regulating the enforcement phase—first clarify whether there is compliance, DSU Article 21, (only) if so, move on to enforcement, DSU Article 22.2. It would also seem to advance the leitmotiv of the WTO dispute settlement mechanism, restated, inter alia, in DSU Article 23, that:

> members should, in the case of a dispute, not unilaterally determine the prerequisites for trade restricting measures; rather, the authorisation of the DSB is requested, as is, the possibility for having the legality of the measures examined by a panel or the Appellate Body.[177]

However, there are timing issues that reveal that the drafters have not sufficiently coordinated those two procedures: The compliance Panel 'shall circulate its report within 90 days after the date of referral of the matter to it', whereas, pursuant to DSU Article 22.6, the DSB has to grant authorization within thirty days after the RPT has expired. Arbitration must be concluded within sixty days after expiry of the RPT. Hence, the 'Article 21.5 cavalry' would arrive thirty days too late, if all deadlines were to be applicable. Also, even if one moves directly to the enforcement phase, the drafters have made sure that there *is control of legality*, thus rendering the argument somewhat moot that moving mandatorily via DSU Article 21.5 would be the preferred avenue from a perspective of avoiding unilateral and unchecked use of economic might.

The question of whether a complainant may successfully request an authorization to impose countermeasures, absent a finding by a (compliance) Panel that the illegality persists as a result of inadequate implementation, arose for the first time in the *EC—Bananas III*[178] dispute. The United States had requested authorization to suspend concessions vis-à-vis the European Community pursuant to DSU Article 22, since, in its view, the latter had not brought its measures into compliance during the RPT. The EC objected, claiming that the measures it had undertaken after the DSB decision had

[177] Alan Yanovich and Werner Zdouc, 'Procedural and Evidentiary Issues' in Daniel Bethlehem, Donald McRae, Rodney Neufeld, and Isabelle Van Damme, eds., *The Oxford Handbook of International Trade Law* (Oxford: Oxford University Press, 2009) 373.

[178] *EC—Bananas III* (Appellate Body).

brought it into compliance as requested by the DSU. According to the EC, the United States was therefore not entitled to request the suspension of concessions *before* a compliance Panel had determined that indeed the EC measures taken after the DSB decision had failed to bring it into compliance with that ruling. To hold otherwise, the EC opined, would constitute a presumption of a finding of non-compliance.

In the US view,[179] the deadline set by DSU Article 22.2 (twenty days after the expiry of the RPT had lapsed) defined the window of opportunity to request authorization to suspend concessions; from that perspective, once that window had closed—that is, after twenty days—the right to authorized suspensions would have vanished like the picture of Dorian Gray.[180] Therefore, the United States proceeded with its request for an authorization to suspend concessions pursuant to DSU Article 22 and requested the DSB to refer the matter to arbitration under DSU Article 22.6 to determine the level of concessions to be suspended.[181] Four days later, Ecuador (the other complainant in the *EC—Bananas III* dispute) requested the establishment of a compliance Panel to rule on whether the EC had indeed complied during the reasonable period of time.[182]

The Arbitrators in *EC—Bananas III (Article 22.6—US)* rejected the EC's request to suspend their proceedings until the compliance Panel had ruled whether compliance had indeed occurred or not:

> [T]he European Communities requested that we suspend this arbitration proceeding . . . until 10 days or so after the date set for the completion of the pending proceedings brought by Ecuador and the European Communities pursuant to Article 21.5 of the DSU in respect of the revised EC banana import regime. However, in light of Article 22.6 of the DSU, which requires that an arbitration thereunder "shall be completed within 60 days after the date of expiry of the reasonable period of time", . . . we decided that we were obligated to complete our work in as timely a fashion as possible and that a suspension of our work would accordingly be inappropriate.[183]

As a result, the report by the Arbitrators pursuant to DSU Article 22.6 determining the level of concessions to be suspended was circulated three days before the compliance Panel, in discharging its functions under DSU Article 21.5 (established at the request of Ecuador), circulated its report where it found that the EC had not complied with its obligations during the reasonable period of time.[184]

[179] Ibid. Recourse to DSU Art. 21.5 by the United States (WT/DS27/RW/USA), para. 4.52.

[180] This position might be a tenable understanding of the wording of DSU Art. 22.2, but one wonders whether it sufficiently considers its systematic context, its function, and purpose. Art. 22.2 rather sets a minimum time, during which parties shall negotiate without the distraction of potential requests to enforce. It is DSU Art. 22.6 which sets a deadline of thirty days from the RPT, within which time the DSB shall grant an authorization to suspend concessions.

[181] WTO Doc WT/DS27/43 of 14 January 1999; see also for an overview of the *EC—Bananas II* case and its procedural issues, Mauricio Salas and John H. Jackson, 'Procedural Overview of the WTO, EC—Banana Dispute' (2000) *Journal of International Economic Law* 3(1), 145–66.

[182] *EC—Bananas III (Article 21.5—Ecuador)* Constitution of the Panel, Note by the Secretariat (WT/DS27/44), 18 January 1999.

[183] *EC—Bananas III (US) (Article 22.6—US)*, para. 2.9.

[184] *EC—Bananas III (Article 21.5—Ecuador)* (Arbitrator), para. 111; see also *US—Import Measures on certain EC Products* (Appellate Body), paras. 6.92–6.94 and *US—Import Measures on certain EC Products* (Panel), which opined that a request for suspension of concessions could only be authorized if a compliance Panel has first ruled that no compliance had occurred during the reasonable period of time; however, in the

The unregulated but nevertheless existing interconnection between DSU Articles 21.5 and 22 is unsatisfactory. The view that an Article 21.5 compliance proceeding precedes a request for an authorization for suspension can use the argument that non-compliance is a prerequisite for legally applying suspensions: how then, the reasoning would go, can an Arbitrator decide on the appropriate level of suspensions without knowing whether or not a member has brought its measures into compliance with its WTO obligations?[185] However, this line of argumentation does not fully address timing issues: pursuant to DSU Article 22.6 a request for an authorization to suspend concessions shall be granted by the DSB 'within 30 days' of the expiry of the reasonable period of time, while in accordance with Article 21.5, a compliance Panel has ninety days from the expiry of the reasonable period of time to circulate its report. Thus, if the term 'within 30 days' is indeed to be interpreted as establishing a one-shot window of opportunity (as was claimed by the United States) the situation becomes untenable for the law-abiding complainant: once the compliance Panel has issued its report, the time to grant an authorization to retaliate would likely have elapsed.

Initially, it was the Arbitrators and Panellists in that first 'sequencing procedure' that found 'the logical way forward'[186] to overcome the DSU's sub-optimal drafting: Two adjoining provisions dealing with interrelated issues fail to take notice of each other. The Article 21.5 Panellists found that the EC had not properly implemented the ruling and recommendation of the DSB, three days after the same individuals, discharging their functions as Arbitrators in the Article 22.6 arbitration had found the requested US countermeasures to be 'equivalent' pursuant to DSU Article 22.6 (see earlier). Following that example, parties in all subsequent implementation disputes agreed explicitly that the requests for suspension of concessions and the referral to an Article 21.5 compliance Panel would be made concurrently, providing however, that retaliation procedures are suspended until after the compliance Panel circulates its report.[187]

In the alternative, the parties may agree to preserve the right to request for an authorization to suspend concessions until a certain time after the compliance Panel has circulated its report, notwithstanding the time limit set by Article 22.6.[188] It seems obvious that amending the DSU in order to eliminate this procedural malfunction

Panel's view, an Arbitrator mandated to determine the level of concessions to be suspended could also determine whether compliance occurred.

[185] Sherzod Shadikhodjaev, *Retaliation in the WTO Dispute Settlement System* (Kluwer Law International, 2009) 155.

[186] In the words of the DSB's chairperson when appointing the Arbitrators in the Art. 22.6 proceedings, noting that they were also Panellists in the Art. 21.5 proceeding.

[187] Alan Yanovich and Werner Zdouc, 'Procedural and Evidentiary Issues' in Daniel Bethlehem, Donald McRae, Rodney Neufeld, and Isabelle Van Damme, eds., *The Oxford Handbook of International Trade Law* (Oxford: Oxford University Press, 2009) 374; see also with respect to the *sequencing* issue: David Palmeter, 'The WTO Dispute Settlement System in the Next Ten Years' in Merit E. Janow, Victoria Donaldson, and Alan Yanovich, eds., *The WTO: Governance, Dispute Settlement & Developing Countries* (New York: Juris Publishing Inc., 2008) 848–9. Such a sequencing agreement was reached between the parties in *Canada—Dairy* (Mutually Agreed Solution) and *Japan—Apples* (Mutually Agreed Solution).

[188] See, for example, *Australia—Automotive Leather II* (Mutually Agreed Solution), *Brazil—Aircraft* (Mutually Agreed Solution), and *Canada—Aircraft* (Mutually Agreed Solution).

would be welcomed. This amendment may well be achieved as part of the Doha Round, should the latter be successful.[189]

10. Conclusions

The WTO dispute settlement mechanism is a remarkable success: In the last twenty years, it has established itself as the premier international dispute settlement mechanism. Panels and in particular the Appellate Body (and the less visible heads behind them) are recognized as producing high-quality work, taking arguments by parties seriously and creating legal certainty and predictability.

This does not mean, however, that the status quo is perfect. With regard to the questions discussed in this chapter, the possibly most irritating aspect is the lack of a right of the aggrieved party to claim compensation for the economic consequences of the violation of its rights under the covered agreements. Rather, the wrongdoer knows that the system established by the DSU virtually guarantees that WTO violations will only have any *legal* consequences for the wrongdoer, once the RPT has ended. Very often that means up to three years of illegal behaviour that can be exercised before the aggrieved party has a right to counteract, pursuant to DSU Articles 22 and 23. For a small or medium economic power, who has few other possibilities to influence its trade partners, this status quo is sub-optimal. Having said this, small and medium-sized economic powers will also think twice before suspending any concessions or obligations.

There is little doubt that this weakness of the law on remedies is also one of the reasons why all trade powers—including all permanent members of the UN Security Council, all important regional powers (with the exception of Iran), indeed the whole world—have accepted the WTO mandatory dispute settlement mechanism. States who are normally extremely reluctant to accept judicial control—the Security Council's reaction to modest attempts to protect fundamental due process rights of individuals caught by the dragnet of UN sanctions may be recalled—accept that they are fully accountable to the WTO DSB and their fellow members for the compatibility of their state measures with WTO law. It would not have been thought, perhaps, that the world's superpowers would be prepared to accept a system that, in addition to these remarkable traits, would oblige them to 'wipe out all the consequences'[190] of their WTO-incompatible measures. In addition, if one recalls that very few states are in a position

[189] David Palmeter, 'The WTO Dispute Settlement System in the Next Ten Years' in Merit E. Janow, Victoria Donaldson, and Alan Yanovich, eds., *The WTO: Governance, Dispute Settlement & Developing Countries* (New York: Juris Publishing Inc., 2008) 849.

[190] *Case concerning the Factory at Chorzow* (Chorzow Factory-Fall), Merits, PCIJ, Ser. A, No.13, 47: 'The essential principle contained in the actual notion of an illegal act—a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals—is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if the act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it—such are the principles which should serve to determine the amount of compensation due for an act contrary to international law.'

to take enforcement measures without doing themselves more harm than good,[191] clearly we are looking at a scenario where the law is highly unlikely to change. The only potential for substantive change imaginable would seem to lie in creating a legal right to claim compensation once the RPT has expired, but even this looks like an ambitious plan for the future.

These fundamental issues should, of course not stand in the way of incremental progress. The sequencing issue is the consequence of an oversight, and could easily be fixed, if the membership is prepared to address this in the Doha Round, or as a matter of secondary institutional law. Other shortcomings that have become visible and relevant over the last twenty years[192] should, of course, also be addressed.

[191] Whether the (friendly) trade superpowers US and EU that have used countermeasures pursuant to DSU Art. 22 are indeed benefiting their respective economies is far from certain.

[192] For a discussion of the most important proposals, in addition to the contributions in Chad P. Bown and Joost Pauwelyn, eds., *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (Cambridge University Press, 2010), see Edwini Kessie, 'The Early Harvest Negotiations in 2003' in Federico Ortino and Ernst-Ulrich Petersmann, eds., *The WTO Dispute Settlement System 1995–2003* (The Hague: Kluwer, 2004) 115–50; Kyle Bagwell, Petros C. Mavroidis, and Robert W. Staiger, 'The Case for Tradable Remedies in WTO Dispute Settlement' in Simon J. Evenett and Bernard Hoekman, eds., *Economic Development & Multilateral Trade Cooperation* (Washington DC: Palgrave McMillan & The World Bank, 2005) 395–414; Marco Bronckers and Naboth van den Broek, 'Financial Compensation in the WTO, Improving the Remedies of the WTO Dispute Settlement' (2002) *Journal of International Economic Law* 8, 101–26.

6

Most Favoured Nation Treatment

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1. The Most Favoured Nation Obligation as a Manifestation of the Principle of Non-discrimination

The elimination of discriminatory treatment in international trade relations is one of the core values of the multilateral trading system.[1] In operational WTO law, this principle has found two main expressions: (1) the obligation of most favoured nation (MFN) treatment, contained most prominently in GATT Article I, SPS Article 2.3, TBT Article 2.1 (with regard to goods), GATS Article II (with regard to services), and TRIPs Article 4 (with regard to intellectual property rights); and (2) the national treatment (NT) obligation, contained most prominently in GATT Article III, GATS Article XVII, and TRIPs Article 3. While a national treatment obligation prohibits discriminatory treatment of lawfully '*imported* products vis-à-vis like *domestic* products'[2] ('inland parity'), the MFN obligation restricts the right of members to discriminate '*between*

[1] See para. 2 of the Preamble to the Agreement Establishing the World Trade Organization; other purposes and functions include 'raising the standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, the expansion of the production and trade in goods and services, the optimal use of the world's resources in accordance with the objective of sustainable development, protection and preservation of the environment, and securing for developing countries a share in the growth in international trade commensurate with the needs of their economic development.'

[2] *EC—Seal Products* (Appellate Body), para. 5.79 (emphasis in the original).

and among like products of different origins'[3] ('foreign parity').[4] The following two chapters will introduce the reader to these two central obligations of WTO law.

This chapter focuses on the most favoured nation obligation in the GATT. The Appellate Body has observed that, apart from GATT Article I:1, 'several "MFN type" clauses dealing with varied matters are contained in the GATT 1994'.[5] These provisions 'relate to such matters as internal mixing requirements (Article III:7); cinema films (Article IV(b)); transit of goods (Article V:2, 5, 6); marks of origin (Article IX:1); quantitative restrictions (Article XIII:1); measures to assist economic development (Article XVIII:20); and measures for goods in short supply (Article XX(j))'.[6] The existence of these provisions 'demonstrates the pervasive character of the MFN principle of non-discrimination'.[7] However, in the interests of space and comprehensibility, we shall focus on the prototypical MFN obligation, GATT 1994 Article I;[8] it reads in pertinent parts:

> 1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.[9]

The MFN principle has an ancient lineage.[10] It is reported that in 1055 the north Italian city of Mantua received from the Holy Roman Emperor the promise that it would always benefit from any privilege granted by the Emperor to 'whatsoever other town'.[11]

[3] *EC—Seal Products* (Appellate Body), para. 5.79 (emphasis in the original).

[4] Holger P. Hestermeyer, 'Art. III GATT' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011), para. 2.

[5] *Canada—Autos* (Appellate Body), para. 82.

[6] Ibid. para. 82, fn. 72.

[7] Ibid. para. 82.

[8] cf. with regard to the relationship between GATT Art. I:1, III:4, and TBT Art. 2.1, *US—Tuna II (Mexico)*, para. 405.

[9] This obligation is addressed to 'contracting parties', only members of the WTO holding that status. As will be recalled, the GATT 1947 was a stand-alone international treaty, not benefiting from any organizational infrastructure. cf. the GATT '"contracting party" in the provisions of the GATT 1994 shall be deemed to read "Member".'

[10] Excellent (and easily accessible) overviews can be found in Michael Trebilcock, Robert Howse, and Antonia Eliason, *The Regulation of International Trade*, 4th edn. (New York: Routledge 2013); the various ILC Reports on the MFN clause, available from the ILC's homepage at <http://www.un.org/law/ilc/>; and John H. Jackson, *World Trade and the Law of the GATT* (Indianapolis: Bobbs-Merrill Company, 1969) 249 *et seq*.

[11] Robert E. Hudec, 'Tiger, Tiger in the House: A Critical Evaluation of the Case Against Discriminatory Trade Measures' in Ernst-Ulrich Petersmann and Meinhard Hilf, eds., *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (Boston: Kluwer, 1988) 165–212, 177, in particular fn. 11; cf. also Gorgio Sacerdoti and Kaarlo Castren, 'Article I GATT, Annexes A, B, C, D, E, F, G GATT, Enabling Clause, Preferential Tariff Treatment for Least-Developed Countries Waiver' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011), para. 1.

Similar arrangements were concluded in other parts of the world.[12] By the early eighteenth century the term 'most favoured [foreign] nation' seems to have become common.[13] More important than this impressive historic progeny is the use of the MFN clause by the country that can be called the 'midwife', if not the parent, of modern GATT law, the United States.[14] Departing completely from the position it had taken in the preceding century (in opposition to many European powers), the United States became a sustained proponent of unconditional MFN treatment after the First World War.[15] In particular, MFN was a cornerstone of the US Reciprocal Trade Agreements Act of 1934, which became the blueprint for the GATT and was a reason why the GATT was concluded as an executive agreement by the Truman administration in 1947.[16]

Despite its status as the 'cornerstone of the GATT' and 'one of the pillars of the WTO trading system',[17] MFN has suffered significant erosion in recent years. Since the conclusion of the Uruguay Round,[18] more than 300 bilateral and multilateral free trade and economic partnership agreements (in the following FTA or PTA) have been concluded,[19] which create preferential conditions for the trade between the countries involved and thus run counter to the very function of the MFN obligation as ensuring the equality of opportunity of WTO members to compete for market share in fellow member states.[20] These arrangements function as exceptions to MFN treatment and are not subjected to any meaningful *ex ante* control (see Chapter 14). FTAs have become so common that the 'Sutherland Report' on 'The Future of the WTO' commented as follows:

> [N]early five decades after the founding of the GATT, MFN is no longer the rule; it is almost the exception. Certainly, much trade between the major economies is still conducted on an MFN basis. However, what has been termed the "spaghetti bowl" of customs unions, common markets, regional and bilateral free trade areas, preferences and endless assortment of miscellaneous trade deals has almost reached the point

[12] cf. Endre Ustor, 'The Most-Favoured-Nation Clause in the Law of Treaties', Working Paper (A/CN.4/L.127), *Yearbook of the International Law Commission*, Vol. II (1968), 159 (available at <http://untreaty.un.org/ilc/documentation/english/a_cn4_l127.pdf>).

[13] See, for example, Art. XII of the Treaty of Paris of 30 May 1814 between the United Kingdom and France, BFSP Vol. I, 151.

[14] Extensive discussion of that influence can be found in John H. Jackson, 'The General Agreement on Tariffs and Trade in United States Domestic Law' (1967) *Michigan Law Review*, Vol. 6, 249.

[15] Michael Trebilcock, Robert Howse, and Antonia Eliason, *The Regulation of International Trade*, 4th edn. (New York: Routledge 2013), n. 10 at 56.

[16] Richard Carlton Snyder, *The Most-Favored-Nation Clause: Analysis with Particular Reference to Recent Treaty Practice and Tariffs* (New York: Columbia University Press, 1948).

[17] *EC—Tariff Preferences* (Appellate Body), para. 101; *Canada—Autos* (Appellate Body), para. 84.

[18] The important role of MFN for the success of Trade Negotiating Rounds has been recognized by *US—Section 211 Appropriations Act* (Appellate Body), para. 297: '[T]he "most-favoured-nation treatment" in Article I . . . has been both central and essential to assuring the success' of the multilateral trading system.

[19] WTO Secretariat, ed., *World Trade Report 2011*, 47; for up-to-date information check <https://www.wto.org/english/tratop_e/region_e/region_e.htm>. As of 7 April 2015, some 612 notifications of FTAs (counting goods, services, and accessions separately) had been received by the WTO. Of these, 426 notifications were made under GATT Art. XXIV; 39 under the Enabling Clause; and 147 under GATS Art. V. Of these 612 FTAs, 406 were in force. The overall number of RTAs in force has been increasing steadily, a trend likely to be strengthened by the many RTAs currently under negotiations. Of these RTAs, FTAs and partial scope agreements account for 90 per cent, while customs unions account for 10 per cent. These WTO figures correspond to 449 physical RTAs (counting goods, services, and accessions together), of which 262 are currently in force.

[20] cf. *EC—Bananas III* (Appellate Body), para. 190; *Canada—Autos* (Appellate Body), para. 84.

> where MFN treatment is exceptional treatment. Certainly the term might now be defined as LFN, Least-Favoured-Nation treatment.[21]

Thus, we are experiencing today a significant departure from the traditional unconditional MFN treatment in international trade, a trend likely to continue in the years to come—at least until the multitude of regional arrangements may again require less complex regulation, which a *General* Agreement on Tariffs and Trade would then (again) be able to provide.

2. GATT Article I

2.1 Policy rationale

The main theoretical-political argument advanced in favour of MFN treatment is that non-discrimination in international trade is a corollary of the principle of sovereign equality of nations, as expressed in Article 2(1) of the United Nations Charter. Thus, the general rule of interstate economic relations in a global organization such as the WTO should be equal treatment, that is, MFN treatment.

However, the classic justification for MFN is not political but economic: Based on past performance, market-based economies tend to create more wealth than state-run economies. MFN is the child of an economic theory that has developed the theoretical underpinnings for viewing markets as most efficient engines for creating global welfare. Unconditional MFN not only provides a mechanism for the automatic removal of distortions that would otherwise hamper comparative advantage, it also guards against erosion of existing trade concessions through 'favours' granted to some, but not all states.[22] In particular, the MFN-obligation provides a 'multiplier effect' which assures that any advantage accorded to one state will spread throughout the multilateral trading system. MFN therefore may reduce corruption and the 'buying' of special favours; it also protects against retaliatory 'tit for tat' cycles of animosity between trading partners (as the treatment due to more distant friends is never to be lesser than the one enjoyed by close friends). Prototypically,[23] MFN counteracts 'bilateral opportunism', the tendency of states to seek advantageous bilateral deals that advantage their terms of trade but create trade externalities for other nations.[24] Simplicity of administration is enhanced by MFN because all trade from all nations is subject to the same standards; this argument remains particularly pertinent for small and medium-sized enterprises (SMEs) who have not the resources to administer vastly different rules of origins in different FTAs.[25]

[21] 'The Future of the WTO', Report by the Consultative Board to Director-General Supachai Panitchpakdi, WTO, 2004 ('Sutherland Report') para. 60. The language quoted seems to be shaped especially by one of the participants, Jagdish Bhagwati. See Jagdish Bhagwati, *Free Trade Today* (Princeton, NJ: Princeton University Press, 2003) where the term LFN (least favoured nation) is commonly used.

[22] Warren F. Schwartz and Alan O. Sykes, 'The Positive Economics of Most-Favoured-Nation Obligation and its Exceptions in the WTO/GATT System' in J. Bhandari and A. Sykes, eds., *Economic Dimensions in International Law* (Cambridge: Cambridge University Press, 1998) 43–75.

[23] As to what is going on in reality, see Chapter 14.

[24] See generally Kyle Bagwell and Robert W. Staiger, *The Economics of the World Trading System* (Boston: MIT Press, 2002).

[25] As a consequence, they often opt in practice for the less advantageous MFN treatment, in order to avoid administrative costs, and sanctions for incorrect customs declarations.

These significant advantages must be weighed against the one big (real or imagined) disadvantage of MFN, which is that 'free riders' may take advantage of the system by claiming the benefits of trade liberalization while keeping their own markets closed.[26] Along with MFN, therefore, WTO law addresses the 'free rider' through mechanisms such as holding periodic 'rounds' of trade negotiations which are not successfully concluded until all members are reasonably satisfied by the trade concessions made.[27]

The WTO MFN clauses prohibit members from differentiating between (more or less well-liked) fellow members. GATT's main MFN obligation—embodied in GATT Article I:1—specifically outlaws discrimination among like products originating in or destined for different countries. By doing so, this obligation has been 'central and essential to assuring the success of a global rules-based system for trade in goods'.[28] More specifically, it ensures equality of competitive opportunities for like imported products from all members.[29] 'It is for this reason that neither Article I:1 nor Article III:4 require a demonstration of the *actual* trade effects of a specific measure.'[30]

Article XVI:4 of the WTO Agreement requires every member to ensure the conformity of its laws, regulations, and administrative procedures with its obligations under GATT. Thus, GATT Article I:1 and all other MFN clauses impose a restriction on the freedom of sovereign states to take certain measures they may deem appropriate: A WTO member may not treat its 'friends' better than other members unless it decides to enter into a GATT Article XXIV-consistent preferential trade agreement. In order to determine how far this restriction of state sovereignty extends, we will analyse, according to the well-established interpretative methods for international treaties, the elements of GATT Article I:1: What kinds of state measures are covered? What is an 'advantage, favour, privilege or immunity' that has to be extended to every other WTO member? When are products considered 'like' for purposes of Article I? What does it mean to require 'immediate and unconditional' extension of the advantages to all members? We address these elements in turn.

2.2 Measures covered

The wording used for describing the measures covered by GATT Article I is broad, leaving no doubt as to the intention of the drafters to subject all measures with the potential to affect international trade to the MFN obligation: Both so-called *border measures* ('customs duties and charges of any kind imposed on or in connection with

[26] Trade liberalization occurs when trading partners agree to lower their respective trade barriers, in order to receive reciprocal trade benefits from their counterparts; once a critical mass of willing partners has been established, it may be advantageous to go ahead, despite the free riders not being prepared to offer some quid pro quo. MFN ensures that the free rider is able to benefit without making any contribution of their own.

[27] See Wilfred J. Ethier, 'Political Externalities, Non-discrimination, and a Multilateral World' (2004) *Review of International Economics* 12, 303–20.

[28] *US—Section 211 Appropriations Act* (Appellate Body), para. 297.

[29] cf. *US—COOL* (Panel), para. 7.571; *Colombia—Ports of Entry* (Panel), para. 7.236; *Argentina—Hides and Leather* (Panel), para. 11.20, the former two referring to *Japan—Alcoholic Beverages II* (Appellate Body), 16; and *Korea—Alcoholic Beverages* (Appellate Body), paras. 119, 120, and 127.

[30] cf. *EC—Seal Products* (Appellate Body), para. 5.82, and emphasized in para. 5.95, fn. 1019.

importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation') as well as 'all matters referred to in paragraphs 2 and 4 of Article III', that is, *internal ('behind-the-border') measures* which are not legally linked to the border-crossing—but rather are applied after the product has legally entered the market—are covered. This clearly reveals the intent to not allow members to influence through unilateral state measures the competitive relationship between like products from different members. Panels will have to examine, whether the measure in question, pursuant to its 'design, structure, and expected operation',[31] detrimentally affects the conditions of competition between and amongst imported 'like products'.[32] In *EC—Seal Products*, the market access accorded to seal products from Greenland as a consequence of certain custom-tailored exceptions was, in the Panel's view, not extended in a similar fashion to Canadian and Norwegian seal products.[33]

'Customs duties and charges of any kind imposed on or in connection with importation or exportation' (GATT Article I: 1) is treaty terminology for *tariffs*. Unless justified under an exception, a member has to grant equal tariff treatment to imports and exports from and to other members. This equality of treatment principle applies both to 'bound' duties (tariff duties that have been bound as a part of members' schedules under GATT Article II) and unbound duties (tariffs for goods for which no such bindings exist). The MFN obligation is, of course, also relevant for tariffs set lower than the bound duty rate. Thus, if a tariff is set[34] at a level lower than the bound rate in a schedule of concession under GATT Article II for one WTO member, the same lower tariff rate must be extended to all WTO members,[35] that is, to their 'like products'. Covered measures include, in particular, 'trade defence' measures ('trade remedies') such as antidumping duties,[36] countervailing measures,[37] and safeguard measures.[38]

[31] *EC—Seal Products* (Panel), para. 7.597.

[32] *EC—Seal Products* (Appellate Body), para. 5.95.

[33] *EC—Seal Products* (Panel), para 7.600.

[34] Or just granted de facto to benefit a particular product from a friendly state.

[35] In *Spain—Unroasted Coffee*, the GATT Panel, after noting that Spain had not bound under the GATT its tariff rate for unroasted coffee, ruled that Art. I:1 equally applied to bound and unbound tariff items. (GATT Panel report, *Spain—Tariff Treatment of Unroasted Coffee*, L/5135, adopted 11 June 1981, B.I.S.D. 28S/102 (*Spain—Unroasted Coffee*)), para. 4.3.

[36] cf. Anti-Dumping Agreement Art. 9.2; *EC—Fasteners* (Appellate Body), para. 392 recognizes that an antidumping duty may be imposed inconsistently with Art. I:1; however, the Panel's pertinent finding was declared moot due to an erroneous analysis; in *US—Anti-Dumping and Countervailing Duties (China)* (Panel), the Panel recognizes that state measures during antidumping investigations 'fall within the scope of Article I:1'; ibid. para. 14.167, referring to the GATT 1947 Panel report *US—MFN Footwear*, para. 6.9.

[37] cf. Subsidies and Countervailing Measures Agreement Art. 19.3; if a subsidy is not subjected to the disciplines of Art. II:2 or III:4, as a consequence of being covered by Art. III:8, it is, according to *EC—Commercial Vessels* (Panel), para. 7.76 *et seq*., not a measure 'falling within the scope of the subject matter of Article I:1'.

[38] cf Agreement on Safeguards, Arts. 2.2, 5.2(b), and 9.1; see also *US—Line Pipe* (Appellate Body), para. 181; *US—Steel Safeguards* (Appellate Body), para. 441; *US—Wheat Gluten* (Appellate Body), para. 96.

Consular fees,[39] *tax rebates*,[40] and *customs user fees*[41] equally fall into the wider category of covered duties and charges. GATT Article I:1 covers not only positive actions but also *omissions* that may confer an advantage. In the *US—Customs User Fee Case*, the Panel rightly recognized that an exemption from the imposition of a customs fee should be considered as an advantage in the sense of GATT Article I:1.[42]

Pursuant to GATT Article I:1, the MFN obligation extends not only to duties and charges as such, but also to the methods of determining them ('method of levying such duties and charges'). For example, the methods of calculating countervailing duties[43] or the administration of tariff quotas must not be administered on a discriminatory basis.[44]

MFN coverage extends not only to fiscal but also to *non-fiscal* border measures; for instance, in *EC—Bananas III*, the border measures found to violate Article I:1 were the use of less complicated licensing procedures,[45] incentives to operators to purchase bananas of a particular origin,[46] the issuance of licences to import bananas of a particular origin dependent upon the economic activity performed by the economic operators requesting the licence,[47] the granting of licences exclusively to operators representing producers of only certain countries,[48] and the imposition of in-quota tariff rates only for bananas originating from certain countries.[49]

While the application of GATT Article I:1 to tariffs and all administrative and legislative measures is of great importance,[50] the all-encompassing coverage of the MFN obligation is due to the explicit reference to GATT Articles III:2 and III:4. These provisions address 'internal measures' such as taxes imposed on products and 'laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use'. This means that both border and internal measures affecting imported goods will be subject to the MFN obligation of Article I:1.[51]

[39] Ruling by the Chairman, *The Phrase "Charges of any Kind" in Article I:1 in Relation to Consular Taxes*, 24 August 1948, B.I.S.D. II/12.

[40] Ruling by the Chairman, *Application of Article I:1 to Rebates on Internal Taxes*, 24 August 1948, B.I.S.D. II/12.

[41] GATT Panel report, *US—Customs User Fee*, L/6264, adopted 2 February 1988, B.I.S.D. 35S/245.

[42] See ibid. paras. 122–3; GATT Panel Report, *US—Denial of Most-Favoured-Nation Treatment as to Non-Rubber Footwear from Brazil*, DS18/R, adopted 19 June 1992, B.I.S.D. 39S/128, (*US—MFN Footwear*), para. 6.8.

[43] *US—MFN Footwear*, para. 6.8.

[44] *EC—Poultry* (Appellate Body), para. 94 *et seq.*

[45] *EC—Bananas III (Ecuador)* (Panel), para. 7.188 *et seq.*

[46] Ibid. para. 7.194 *et seq.*

[47] Ibid. para. 7.220 *et seq.*, upheld by the Appellate Body in *EC Bananas III (*Appellate Body), para. 206.

[48] Ibid. para. 7.251 *et seq.*

[49] Ibid. para. 7.235 *et seq.*, upheld by the Appellate Body in *EC—Bananas III* (Appellate Body), para. 207.

[50] *Canada—Autos* (Appellate Body), para. 84; see also *EC—Tariff Preferences* (Appellate Body), para. 101.

[51] An early example is the well-known *Belgium—Family Allowances (allocations familiales)* case (GATT Panel report, *Belgian Family Allowances*, G/32, adopted 7 November 1952, B.I.S.D. 1S/59, *(Belgium—Family Allowances)*, para. 4) that rejected the view that the likeness of product may be influenced by the process and production methods (PPM). In *China—Audiovisual Services*, the Appellate Body opined in fn. 564: 'According to Article I:1 of the GATT 1994, all matters referred to in paragraphs 2 and 4 of Article III are also subject to the requirement that any advantage, favour, privilege, or immunity be accorded to the like product. This also suggests a broad coverage and consideration of trade effects'. See also Sacerdoti and Castren, 'Article I', n. 11 at para. 9; and *Canada—Autos* (Appellate Body), para. 79.

The MFN obligation is not limited to advantages granted to fellow WTO members; rather, Article I covers 'any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for *any other country*.'[52] Thus if a WTO member grants an advantage to a state that is not a member of the WTO, all WTO members have a right to the same treatment.

2.3 'Any advantage, favour, privilege or immunity'

What is an 'advantage, favour, privilege or immunity'? As the GATT is a commercial agreement, one would be inclined to state that those terms try to capture any effect that benefits market access (border measures) or otherwise influences competitive relationships with other foreign products (border measures and internal measures), thus creating 'more favourable competitive opportunities for products from one member than for products from another member, thereby affecting their commercial relationship.[53] Panels and the Appellate Body concur with this broad view.[54] In *Canada—Autos*, the Appellate Body stated that the

> words of Article I:1 refer not to *some* advantages granted "with respect to" the subjects that fall within the defined scope of the Article, but to "any advantage"; not to *some* products, but to "any product"; and not to like products from some other Members, but to like products originating in or destined for "*all other*" Members.[55]

Examples from the jurisprudence render this broad leitmotiv more operational. The automatic backdating of the revocation of a countervailing duty order without the need to have an injury review conducted in this respect is considered to be an advantage in the sense of GATT Article I:1.[56] Any other decision would run counter to the realities of international trade, where expeditious border treatment is viewed as a benefit. Granting an import duty exemption to motor vehicles originating from certain countries constitutes an 'advantage' within the meaning of GATT Article I:1 GATT;[57] having to pay less to the state for whatever reason is a competitive advantage caused by a state measure.[58] Less onerous import requirements constitute an 'advantage': in *EC—Bananas III*, the Appellate Body found that rules under which importers of bananas from some countries qualified for the allocation of a tariff quota if they fulfilled requirements, which differed from those imposed on importers of bananas

[52] Emphasis added.

[53] *US—Poultry (China)* (Panel), paras. 7.415–7.417; the negation of the opportunity to export poultry products to the United States meant 'a serious competitive disadvantage' (ibid. para. 7.416); *Colombia—Ports of Entry* (Panel), para. 7.341; see also *EC—Bananas III (Guatemala and Honduras)* (Panel), para. 7.239.

[54] See *Colombia—Ports of Entry* (Panel), para. 7.340 *et seq*. with further references; but see also *US—Anti-Dumping and Countervailing Duties (China)* (Panel), para. 14.150 *et seq*.

[55] *Canada—Autos* (Appellate Body), para. 79; see also *EC—Bananas III* (Appellate Body), para. 206, with extensive references to prior GATT jurisprudence.

[56] *US—MFN Footwear* (GATT Panel), para. 6.12 *et seq*.

[57] *Canada—Autos* (Panel), para. 10.16.

[58] The definition of subsidy in Art. 1.1(a)(1)(ii) of the SCM Agreement makes clear that a state's omission to collect money otherwise due is a state measure (a benefit to the one spared from full financial burdens).

from other countries conferred an advantage for the purposes of Article I:1.[59] The *EC—Bananas* cases show that virtually any discriminatory administrative treatment will constitute an 'advantage'.[60] Similarly, in *EC—Poultry*, the Appellate Body emphasized that when determining rates under tariff quotas, WTO members must ensure that they adhere to the non-discrimination principle.[61] In the recent *EC—Seal Products* report, the Panel opined that 'advantage granted' was the market access, which virtually all Greenland's seal products received due to exceptions tailored to meet Greenland's needs, whereas seal products from Canada and Norway did not qualify for the exception's requirements.[62]

2.4 'Like product'

2.4.1 The basic definition of 'like product'

GATT Article I:1 obligation requires members to extend any advantage granted by a member to any product originating in or destined for any other country immediately and unconditionally to the 'like products' originating in or destined for all other members.[63] Accordingly, 'unlike' products may lawfully be treated very differently. 'Likeness' determines, therefore, whether treating apples from *Arcadia* differently than pears from *Pneumonia* is illegal discrimination pursuant to Article I:1 or perfectly legal differential treatment of 'unlike' products. The following chapter will discuss in great detail the term 'like product' in the context of national treatment (NT); therefore, we limit ourselves in this chapter to a more succinct treatment of this term.

The term *like product* has not received an authoritative definition in the text of the GATT. Clearly, 'like products' are characterized by common traits and show identical or similar characteristics.[64] Given the purpose of Article I to protect the equality of competitive opportunities, the determination of likeness is really a determination of competitive relationships between different products.[65] Whereas the term *like product* is used sixteen times in the GATT alone, each provision must be interpreted on its own pursuant to its context and purpose: identical words may (but need not) have identical meaning.[66] More often than not, the specific meaning is somewhat different, due to the

[59] *EC—Bananas III* (Appellate Body), para. 206.

[60] See *Columbia—Ports of Entry* (Panel), para. 7.352, referring to *EC—Bananas III (Article 21.5—Ecuador II*) (Appellate Body), para. 7.153; and *EC—Bananas III (Article 21.5—US)* (Appellate Body), para. 7.560.

[61] *EC—Poultry* (Appellate Body), para. 96 *et seq.*

[62] *EC—Seal Products* (Panel), para. 7.597 *et seq.*

[63] cf. *EC—Bananas III* (Appellate Body), paras. 190–1: '[T]he essence of the non-discrimination obligation is that like products should be treated equally'; cf. Jonell B. Goco, 'Non-Discrimination, "Likeness", and Market Definition in World Trade Organization Jurisprudence' (2006) *Journal of World Trade* 40(2), 315–40.

[64] *EC—Asbestos* (Appellate Body), para. 91.

[65] *Philippines—Distilled Spirits* (Appellate Body), para. 170; *EC—Asbestos* (Appellate Body), para. 99.

[66] For this well-established proposition see, for example, Judgment of the European Court of Justice of 9 February 1982, Case 270/80, *Polydor Limited and RSO Records Inc. v Harlequin Records Shops Limited and Simons Records Limited* [1982] ECR 329, para. 15 *et seq.*

context and function of a given norm. The Appellate Body has described this ever-present phenomenon of treaty interpretation with the following poetic[67] picture:

> The concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the *WTO Agreement* are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.[68]

Nevertheless, under well-established case law, all 'like-product' analyses have to consider the following four elements, in order to 'make a determination about the nature and extent of a competitive relationship between and among the products':[69]

- the product's end-uses in a given market;
- consumers' tastes and habits, which change from country to country;
- the product's properties, nature, and quality; and
- tariff classification.

None of these criteria are determinative, as the determination of likeness 'will always involve an unavoidable element of individual, discretionary judgement'.[70]

The first three of these criteria go back to the report of the Working Party on *Border Tax Adjustments* adopted by the GATT contracting parties in 1970:

> [T]he interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.[71]

[67] It is said that the *poet laureatus* was the distinguished Philippine jurist Florentino P. Feliciano, who also coined the dictum that standards must not just stand the test of laboratory conditions, but rather must serve their purpose 'in the real world where people live and work and die', *EC—Hormones* (Appellate Body), para. 187.

[68] *Japan—Alcoholic Beverages II* (Appellate Body), 21.

[69] *Philippines—Distilled Spirits* (Appellate Body), para. 120.

[70] *Japan—Alcoholic Beverages II* (Appellate Body), 20 *et seq*. cf. also *Philippines—Distilled Spirits* (Appellate Body), paras. 119–21 (with regard to Art. III): 'While in the determination of 'likeness' a panel may logically start from the physical characteristics of the products, none of the criteria that a panel considers necessarily has an overarching role in the determination of "likeness"... A panel examines these criteria in order to make a determination about the nature and extent of a competitive relationship between and among the products... products that have very similar physical characteristics may not be "like", within the meaning of Article III:2, if their competitiveness or substitutability is low, while products that present certain physical differences may still be considered "like" if such physical differences have a limited impact on the competitive relationship between and among the products... we do not consider... that the Panel committed an error of interpretation when it found that "likeness under the first sentence of Article III:2 is not limited to products that are identical". This statement by the Panel... is consistent with the notion that, while physical characteristics are one of the relevant criteria in the determination of "likeness" under Article III:2, even products that present certain differences may still be considered "like" if the nature and extent of their competitive relationship justifies such a determination.'

[71] Working Party Report, *Border Tax Adjustments (1970)*, B.I.S.D. 18S/97, para. 18. See also *Japan—Alcoholic Beverages II* (Appellate Body), *20 et seq*.

In *Japan—Alcohol II*, the Appellate Body explicitly accepted this practice.[72] Furthermore, it followed prior Panel reports[73] by adding a fourth element to the *Border Tax Adjustment* test: 'tariff classification can be a helpful sign of product similarity'.[74] Tariff classification is a state measure, and thus independent of market decisions. However, it often influences the markets because of its possible influence on consumer prices. With a similar rationale, the Appellate Body used the internal regulatory regime of a product to determine likeness in *Philippines—Distilled Spirits*.[75] If products are competitive, they may be considered as 'like', even if they have dissimilar physical characteristics.[76]

Scholars and practitioners alike are inclined to interpret the term 'like product' in the context of GATT Article I more narrowly than in other contexts.[77] The 1978 Panel report on *EEC—Animal Feed Proteins*[78] first made the point that GATT Article I does not contain the term *directly substitutable product* used together with *like product* in GATT Article III. The Panel inferred from this observation that the drafters of GATT envisaged a narrower scope for the term 'like product' in GATT Article I than they did in the context of GATT Article III and in particular recognized implicitly the relevance of tariff classification.[79]

Following this line of thinking, the Panel report in *Japan—SPF Dimension Lumber*[80] provides the most explicit acknowledgement of the relevance of tariff classification as an important criterion to determine likeness. Tariff classification takes place on the basis of a classification system (known as the 'Harmonized System' or 'HS') established under the auspices of the World Customs Organization (WCO), which allows extremely narrow classifications of goods (and thus limited commitments). Two products can be directly competitive or substitutable and nevertheless be earmarked differently for the purposes of the Harmonized System of classification.[81] State practice shows that states have indeed regularly used very detailed tariff classifications and, in doing so, both made directly competitive or substitutable products 'unlike' and limited

[72] *Japan—Alcoholic Beverages II* (Appellate Body), 20–4.

[73] GATT Panel report, *EEC—Measures on Animal Feed Proteins*, L/4599, adopted 14 March 1978, B.I.S.D. 25S/49 *(EEC—Animal Feed Proteins)*, para. 4.2; GATT Panel report, *Japan—Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, L/6216, adopted 10 November 1987, B.I.S.D. 34S/83, para. 5.6; and *US—Gasoline* (Panel), para. 6.8.

[74] *Japan—Alcoholic Beverages II* (Appellate Body), 21–2.

[75] *Philippines—Distilled Spirits* (Appellate Body), para. 128.

[76] Ibid.

[77] Robert E. Hudec, '"Like Product": The Differences in Meaning in GATT Articles I and III' in Thomas Cottier and Petros C. Mavroidis, eds., *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (Ann Arbor: University of Michigan Press, 2000) 101–23, arguing that the concept of 'like product' in Art. I 'should be interpreted to allow rather fine distinctions between products when it is applied to product distinctions made by tariffs'; see also William J. Davey and Joost Pauwelyn, 'MFN Unconditionality: A Legal Analysis of the Concept in View of its Evolution in the GATT/WTO Jurisprudence with Particular Reference to the Issue of "Like Products"' in Thomas Cottier and Petros C. Mavroidis, eds., *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (Ann Arbor: University of Michigan Press, 2000) 13–50; for a comprehensive discussion see Holger P. Hestermeyer, 'Art. III GATT' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011), n. 4 at paras. 28–37, 67–75.

[78] *EEC—Animal Feed Proteins*, paras. 4.1 and 4.2.

[79] Ibid. para. 4.20.

[80] GATT Panel report, *Canada/Japan—Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber*, L/6470, adopted 19 July 1989, B.I.S.D. 36S/167, 7(*Japan—SPF Dimension Lumber*), paras. 5.13 and 5.15.

[81] For a more thorough discussion of the HS classification system, see Chapter 8.

the scope of tariff commitments. As the Panel stated in *Japan—SPF Dimension Lumber*:

> [I]f a claim of likeness was raised by a contracting party in relation to the tariff treatment of its goods on importation by some other contracting party, such a claim should be based on the classification of the latter, i.e., the importing country's tariff. The Panel noted in this respect that "dimension lumber" as defined by Canada was a concept extraneous to the Japanese Tariff... nor did it belong to any internationally accepted customs classification. The Panel concluded therefore that reliance by Canada on the concept of dimension lumber was not an appropriate basis for establishing "likeness" of products under Article I:1 of the General Agreement.[82]

However, this reliance on tariff classification was not shared by an earlier Panel attempting to determine whether certain coffees were like other coffees, thereby illustrating the insight of the Appellate Body's dictum that the determination of likeness 'will always involve an unavoidable element of individual, discretionary judgement'.[83] In *Spain—Unroasted Coffee*, the Panel had found that, despite different tariff classifications and different physical characteristics arising from different processing methods, the coffees in question ('Columbian mild', 'Other mild', 'Unwashed Arabica', 'Robusta', 'Other') were like for the purposes of Article I. It opined that all coffee was 'mainly, if not exclusively, sold in the form of blends, combining various types of coffee', and that 'coffee in its end-use, is universally regarded as a well-defined and single product'.[84] Whether a decision maker would today come to the same conclusion as the *Spain—Unroasted Coffee* Panel is uncertain. The case illustrates that consumer perceptions may change: when *Unroasted Coffee* was decided, coffee would have been regarded by most people 'as a well-defined and single product'. Such a view may be questionable today, considering that consumers now ask not only for specific coffee varieties, but even for well-defined *crus*, similar to that which has long been common for wine.

Also, non-product-related aspects may today influence consumer preference and, by implication, the 'likeness' of goods. Answers to questions, such as: 'Has the coffee been harvested by labourers getting a fair salary or by the children-inmates of prison camps?' and 'Were environmentally sound process and production methods used?' will determine 'likeness'.[85] We will address these thorny issues in Chapter 7 as they are even more relevant in the context of national treatment.

2.4.2 'Irrespective of origin'

Article I:1 requires WTO members to treat 'like products equally, irrespective of their origin'. Sometimes, however, the origin of a product is less than clear. What is the origin of canned tuna that was caught in Tuvalu coastal waters, but canned in Fiji? Is a

[82] *Japan—SPF Dimension Lumber*, paras. 5.13 and 5.14.
[83] *Japan—Alcoholic Beverages II* (Appellate Body), 20–1.
[84] *Spain—Unroasted Coffee*, paras. 4.7 and 4.10.
[85] See, for example, *EC—Asbestos* (Appellate Body), para. 117 *et seq*, in particular para. 122.

pencil produced in Indonesia, but 'finished' and imprinted in Switzerland by a famous 'producer of writing instruments' a Swiss or Indonesian product? In the context of MFN and GATT Article I, questions of origin have now receded in importance, as substantially all trading nations have become members of the WTO. Origin requirements are now important in the context of preferential trade arrangements, and these questions and the WTO Agreement on Rules of Origin are deferred to Chapter 16.

2.5 'Accorded immediately and unconditionally'

By virtue of the MFN obligation, WTO members must extend any advantage immediately and unconditionally to all WTO members.

The term *immediately* is very strict; less ambitious options, like 'without delay' or 'within a reasonable period of time' would have been less demanding, suggesting that any WTO member has an operative right to demand equal treatment from the moment of first granting of the advantage in question.

The term *unconditionally* means that any advantage given to another trading partner must be accorded to all WTO members, whether or not any conditions are associated with that advantage. The GATT Panel on *Belgium—Family Allowances* was the first to deal with the substantive interpretation of the term *unconditionally*: in its report, it took the view that tax exemptions for products purchased by public bodies made conditional on the existence of a certain system of family allowances in the exporting country were incompatible with GATT Article I:1:

> [The] Belgian legislation would have to be amended insofar as it introduced a discrimination between countries having a given system of family allowances and those which had a different system or no system at all, and made the granting of the exemption dependent on certain conditions.[86]

However, subsequent case law evidences certain inconsistencies on the question of conditional MFN. There is a first strand of dispute settlement reports which interpret the term as equivalent to outlawing *any* conditions imposed by the advantage-granting WTO member. Besides the GATT Panel report on *Belgian Family Allowances* cited earlier, the following reports have adopted this approach:

(a) The GATT Panel report on *EEC—Imports of Beef*[87] reflects the view that conditioning a duty waiver upon certification by a particular government violates the obligation to grant MFN unconditionally because this advantage was *in fact* not made available to all other contracting parties;[88]
(b) The Working Party report on *Accession of Hungary*[89] reflects the view that to condition a tariff treatment upon the prior acceptance of a cooperation

[86] *Belgium—Family Allowances*, para. 3.
[87] GATT Panel report, *European Economic Community—Imports of Beef from Canada*, L/5099, adopted 10 March 1981, B.I.S.D. 28S/92, paras. 4.2 and 4.3.
[88] Note, however, that the Panel did not focus so much on the 'condition' but rather on the fact that the option was not made available to others which would have equally fulfilled these conditions.
[89] *Accession of Hungary* (L/3889, adopted on 30 July 1973), B.I.S.D. 20S/34, 36, para. 12.

agreement is a violation of the requirement imposed by GATT Article I:1 to grant MFN treatment unconditionally;

(c) The WTO Panel report on *Indonesia—Autos*[90] decided that in "the GATT/WTO, the right of Members cannot be made dependent on, conditional on or even affected by, any contractual obligation in place". In addition, any requirement of local content was found to be inconsistent with the obligation under GATT Article I:1 to grant MFN unconditionally;

(d) In *EC—Tariff Preferences*, the Panel rejected the view that the EC was permitted to link special benefits for developing countries to special efforts by the recipients to improve good governance, such as combating drug use and trade:

> [T]he term "unconditionally" in Article I:1 has a broader meaning than simply that of not requiring compensation. While the Panel acknowledges the European Communities' argument that conditionality in the context of traditional MFN clauses in bilateral treaties may relate to conditions of trade compensation for receiving MFN treatment, the Panel does not consider this to be the full meaning of "unconditionally" under Article I:1. Rather, the Panel sees no reason not to give that term its ordinary meaning under Article I:1, that is, "not limited by or subject to any conditions."
>
> Because the tariff preferences under the Drug Arrangements are accorded only on the condition that the receiving countries are experiencing a certain gravity of drug problems, these tariff preferences are not accorded "unconditionally" to the like products originating in all other WTO Members, as required by Article I:1.[91]

It should be noted that the latter statement was not confirmed on appeal, as the Appellate Body allowed the EC measures based on a reading of the Enabling Clause that differed significantly from the Panel's approach.[92]

A second strand of cases takes a more balanced approach:

(a) The GATT Panel report on *EEC—Minimum Import Prices*[93] addressed whether the EC's requirement of a payment deposit from all countries that could not guarantee a specified minimum import price was 'conditional' and hence incompatible with Article I:1. Since the payment of the deposit was requested by all exporting countries falling into this category, the EC scheme was not considered to be a violation of GATT Article I:1;

(b) According to the Panel report on *Canada—Autos* the term *unconditionally* does *not* mean that *all* conditions are prohibited *per se*. Rather, the word 'unconditionally' (only) ought to mean that making an advantage conditional on criteria *related to the imported product itself* would be inconsistent with Article I:1.[94] The Panel explained:

> In our view, whether an advantage within the meaning of Article I:1 is accorded "unconditionally" cannot be determined independently of an examination of whether it involves discrimination between like products of different countries. . . .

[90] *Indonesia—Autos* (Panel), paras. 14.143–14.146.

[91] *EC—Tariff Preferences* (Panel), paras. 7.59 and 7.60.

[92] *EC—Tariff Preferences* (Appellate Body), para. 190.

[93] GATT Panel report, *EEC—Programme of Minimum Import Prices, Licences and Surety Deposits for Certain Processed Fruits and Vegetables*, L/4687, adopted 18 October 1978, B.I.S.D. 25S/68, para. 4.19.

[94] *Canada—Autos* (Panel), para. 10.24.

> In this respect, it appears to us that there is an important distinction to be made between, on the one hand, the issue of whether an advantage within the meaning of Article I:1 is subject to conditions, and, on the other, whether an advantage, once it has been granted to the product of any country, is accorded "unconditionally" to the like product of all other Members. An advantage can be granted subject to conditions without necessarily implying that it is not accorded "unconditionally" to the like product of other Members. More specifically, the fact that conditions attached to such an advantage are not related to the imported product itself does not necessarily imply that such conditions are discriminatory with respect to the origin of imported products.[95]

The Panel's interpretation of 'unconditionally' was not appealed and seems in line with the thrust of the Appellate Body's sophisticated interpretation of what constitutes discrimination in the context of the Enabling Clause,[96] which seems to be the state of play with regard to WTO jurisprudence.[97]

The analytical approach of the *Canada—Autos* Panel would seem to be the preferable one. When interpreting the term *unconditionally* not just according to the wording (no conditions!) but, according to the well-established canon of treaty interpretation, in context and with a view to the purpose of that clause, the MFN obligation in GATT Article I:1 would seem to target state measures that discriminate, in law or in fact, between two (or several) *like products*.

The *Canada—Autos* test is particularly relevant in the context where three criteria of 'likeness' specified in the *Border Tax Adjustment* excerpt do not provide sufficiently clear results, thus enhancing the importance of tariff classification to determine *likeness*. Assuming the internationally determined classification (up to the six-digit level) to be determinative, likeness would be established by a demonstration that a product belongs to the same tariff line. Nothing in the jurisprudence of the Appellate Body requires, however, that national tariff classifications only take into account the internationally harmonized 'general' classification. Rather, WTO members that use the HS are free to add *national* classifications to the internationally mandated six-digit level. Assume, for example, that at the eight-digit level, Argentina grants a more favourable tariff binding to steel products produced using environmentally friendly production methods. One may discuss the wisdom of promoting such policies through border measures, but it would seem that the law of the GATT would not stand in the way of such a choice.[98]

[95] *Canada—Autos* (Panel), paras. 10.22 and 10.24.

[96] cf. *EC—Tariff Preferences* (Appellate Body).

[97] *Columbia—Ports of Entry* (Panel), para. 7.366.

[98] Similar questions are raised by Gorgio Sacerdoti and Kaarlo Castren, 'Article I GATT, Annexes A, B, C, D, E, F, G GATT, Enabling Clause, Preferential Tariff Treatment for Least-Developed Countries Waiver' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011), n. 11 at para. 22, fn. 44. By way of example: If Argentina (A) subsequently starts applying this tariff rate to all products falling into that tariff classification, Brazil (B) may benefit from this new tariff classification, as it has similar standards to A. Columbia, however, does not yet subscribe to the environmental standards shared by A and B. Its steel therefore falls into a different tariff classification. Should, in this framework of analysis, the *original* advantage be considered to be a *condition*? The first series of cases may indicate an affirmative answer. However, tariff line distinctions typically reflect autonomous national policy preferences; the 'unconditionality' requirement of GATT Art. I:1 should not limit the pertinent right of states.

In *EC—Seal Products*, the Appellate Body confirmed this view:

> [A]s Article I:1 is concerned, fundamentally, with protecting expectations of equal competitive opportunities for like imported products from all Members, it does not follow that Article I:1 prohibits a Member from attaching *any* conditions to the granting of an "advantage" within the meaning of Article I:1. Instead, it prohibits those conditions that have a detrimental impact on the competitive opportunities for like imported products from *any* Member. Conversely, Article I:1 permits regulatory distinctions to be drawn between like imported products, provided that such distinctions do not result in a detrimental impact on the competitive opportunities for like imported products from any Member.[99]

Hence, GATT Article I:1 serves to ensure that no discrimination will take place between like products. Its purpose is not to deregulate by constraining the choice amongst the instruments that governments might want to use in order to pursue their social policies.

2.6 De jure and de facto discrimination

GATT Article I does not distinguish between de jure or de facto discrimination. In line with developments in other areas of law, especially of economic law, the Appellate Body does not limit the catchment area of the MFN obligation to the most obvious, that is, explicit, discriminatory measures. Rather, it is the discriminatory effect that really matters.[100] Thus, in *Canada—Autos*, the Appellate Body explained:

> [T]he words of Article I:1 do not restrict its scope only to cases in which the failure to accord an "advantage" to like products of all other Members appears *on the face* of the measure, or can be demonstrated on the basis of the words of the measure. Neither the words "*de jure*" nor "*de facto*" appear in Article I:1. . . . [W]e observe [further] that Article I:1 does not cover only "in law", or *de jure*, discrimination. [Rather,] Article I:1 covers also "in fact", or *de facto*, discrimination. Like the Panel, we cannot accept Canada's argument that Article I:1 does not apply to measures which, on their face, are "origin-neutral".[101]

Thus, in *Canada—Autos*, while the Canadian exemption from import duties for certain motor vehicles imposed no discrimination with respect to origin on its face, in practice, the WTO Panel found 'major automotive firms in Canada import only their own make of motor vehicle and those of related companies.'[102] The Panel accordingly found that the import duty exemption constituted a de facto discrimination inconsistent with GATT Article I:1. This determination was upheld by the Appellate Body.[103]

[99] *EC—Seal Products* (Appellate Body), para. 5.88.

[100] Which is not to say that the Appellate Body or any other jurisprudential decision maker would not be receptive to a plaintiff's showing that a measure not only had a discriminatory effect, but was intended to have that discriminatory effect.

[101] *Canada—Autos* (Appellate Body), para. 78 (emphasis in the original).

[102] *Canada—Autos* (Panel), para. 10.43.

[103] *Canada Auto* (Appellate Body), para. 85.

2.7 No demonstration of effects or intent required

The MFN requirement protects competitive *opportunities*,[104] not any particular status quo or trading situation. Thus, any trade advantage that is accorded to one or more parties but denied to others is inconsistent with Article I:1; it is not necessary to prove that disparate effects flow from the advantage or that the measure that accords the advantage is intended to have a discriminatory effect. As the *EC—Bananas III* Panel stated:

> The requirement to match EC import licenses with BFA [Banana Framework Agreement] export certificates means that those BFA banana suppliers who are initial holders of export certificates enjoy a commercial advantage compared to banana suppliers from third countries.... [W]e also note that the possibility does exist to pass on tariff quota rent to BFA banana producers in such a way, whereas there is no such possibility in respect of non-BFA third-country banana producers. Thus, the EC's requirement affects the competitive relationship between *bananas* of non-BFA third-country origin and bananas of BFA origin.[105]

GATT Article I:1 contains an objective obligation. In line with the general international law on state responsibility, intent is not a precondition for violating such obligation.[106]

2.8 No rebalancing permitted

Disparate MFN treatment cannot be cured or compensated by rebalancing, offsetting a negative practice by according the disadvantaged member more favourable treatment in another area. In both *US—MFN Footwear* and *EC—Bananas III*, Panels ruled that rebalancing is not permitted under GATT Article I:1.[107] It is not the treatment *on balance* that is subject to the analysis under GATT Article I:1; rather, each and every state measure relating to international trade must separately meet the requirements of the MFN. A reading of Article I:1 that would give members the right to re-balance autonomously would endanger the predictability of the GATT, and thus one of the most important benefits of the treaty-based multilateral trading system.[108] Similarly, the MFN obligation is not met by establishing different import regimes and maintaining equality in each separate regime. In *EC—Bananas III*, the Appellate

[104] *Philippines—Distilled Spirits* (Appellate Body), para. 242.

[105] *EC—Bananas III* (Panel), para. 7.239 (emphasis in the original).

[106] cf. Art. 2 of the Draft Articles on State Responsibility (Elements of an internationally wrongful act of a State), General Assembly resolution 56/83 of 12 December 2001, and corrected by document A/56/49 (Vol. I)/Corr.4: 'There is an internationally wrongful act of a State when conduct consisting of an action or omission: (*a*) is attributable to the State under international law; and (*b*) constitutes a breach of an international obligation of the State'. Intent is not mentioned.

[107] *US—MFN Footwear*, para. 6.10 *et seq*.; see also *EC—Bananas III* (Panel), para. 7.239: 'The EC argues that the fact that licenses allowing the importation of non-BFA bananas at in-quota tariff rates are usually exhausted in the first round amounts to an advantage for bananas of Complainants' origin. While we do not endorse the EC's view, even if this were to constitute an advantage, we note that *Article I:1 does not permit balancing more favourable treatment under some procedure against a less favourable treatment under others*.' (Emphasis added.)

[108] See *US—Section 301 Trade Act* (Panel), para. 7.75 with further references in fn. 663.

Body stated that 'the essence of the non-discrimination obligation is that like products should be treated equally irrespective of their origin.... [T]he non-discrimination provisions apply to all imports of bananas irrespective of whether and how a Member categorizes or subdivides these imports for administrative or other reasons.'[109]

2.9 The assumption of 'likeness' in case of origin-based discrimination

Instead of applying the regular four- or five-pronged like product analysis, several Panels have applied a *hypothetical like product analysis* in cases where the difference in treatment between several imported products was based exclusively on the products' origin.[110] If the complainants could show such origin-based discrimination, the Panels abstained from the requirement to identify specific imported products and then establish their likeness. Rather, showing origin-based discrimination leads to an assumption of likeness.[111] Other Panels found (albeit in the context of GATT Article III:2) that 'where a Member draws an origin-based distinction in respect of internal taxes, a comparison of specific products is not required and, consequently, it is not necessary to examine the various likeness criteria.'[112] This was repeated in *US—Poultry (China)*:

> The funding restriction imposed by Section 727 is origin-based in respect of the products it affects, i.e. poultry products from China, and not from any other WTO Member. By targeting only China, Section 727 imposes origin-based discrimination.
>
> Given this origin-based distinction ... it is appropriate to follow prior panels that have used a hypothetical like products analysis. In this sense, for the purposes of determining whether an advantage has been accorded immediately and unconditionally to other WTO Members and not to China, the Panel will assume that poultry products originating from China are like products to those originating from other WTO Members.[113]

Obviously, Panels are of the opinion that state measures that differentiate on the basis of origin are so inherently against the spirit of the non-discrimination principle that they ought to be sanctioned by facilitating complaints against them. On a philosophical level, one may discuss whether this 'facilitation' is indeed prescribed by the Dispute Settlement Understanding (DSU) and thus covered by the role of the Dispute Settlement Mechanism. However, such treatment does convey the message to members that their consensual decision to ban discrimination will be well enforced by the dispute settlement infrastructure they created.

[109] *EC—Bananas III* (Appellate Body), para. 191.

[110] *China—Publications and Audiovisual Products* (Panel), para. 7.1446.

[111] *Indonesia—Autos* (Panel), para. 14.113; *Canada—Autos* (Panel), para. 10.74; *India—Autos* (Panel), paras. 7.174–7.176.

[112] *Canada—Wheat Exports and Grain Imports* (Panel), para. 6.164, fn. 246, referring to *Argentina—Hides and Leather* (Panel), paras. 11.168–11.170.

[113] *US—Poultry (China)* (Panel), paras. 7.431–7.432, referring to *Colombia—Ports of Entry* (Panel), para. 7.357.

3. MFN in the GATS: Preliminary Remarks

The GATS MFN clause, Article II, will be examined in detail in Chapter 16; however, some preliminary remarks seem useful here. It reads in pertinent parts:

> 1. With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.
> 2. A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.

Obviously, the wording is very similar to that in GATT Article I, and the Appellate Body and Panels have rightly used the case law relating to GATT Article I with regard to GATS Article II, as the two provisions have similar functions and render the same principle operational. A significant difference between GATT Article I and GATS Article II is that the latter Article considers not only the commercial product (the like service) in the context of MFN but also the producer, the service supplier. The Panel jurisprudence on 'like' service supplier has so far not been particularly helpful: In *EC—Bananas III*[114] and *Canada—Autos*,[115] the Panels stated, without explaining, only that to the extent that service providers offer like services they are like service suppliers. A more sophisticated approach is the statement of the Panel in *China—Electronic Payments Services*:

> We agree that the fact that service suppliers provide like services may in some cases raise a presumption that they are "like" service suppliers. However, we consider that, in the specific circumstances of other cases, a separate inquiry into the "likeness" of the suppliers may be called for. For this reason, we consider that "like service suppliers" determinations should be made on a case-by-case basis.[116]

Thus, in contrast to GATT, the GATS MFN clause requires a two-tier analysis: after the likeness determination of the product (service), the likeness of the supplier may need to be established.

4. Exceptions to MFN

4.1 Introduction

Each and every of the many exceptions in the WTO Agreement may apply to the MFN obligation. Thus, for instance, GATT Article XXI (the vital interests clause), GATT Article XX (the so-called 'general exception') or, most importantly, GATT Article XXIV (the Free Trade Agreement exception) may justify departures from MFN.[117]

[114] *EC—Bananas III (Ecuador)* (Panel), para. 7.322. [115] *Canada—Autos* (Panel), para. 10.248.
[116] *China—Electronic Payments Services* (Panel), para. 7.705.
[117] See with regard to GATT Art. XIX, *Dominican Republic—Safeguard Measures* (Panel), paras. 7.69–7.73.

As always, the analysis of whether a state acts in a WTO-incompatible manner only starts with the question whether it was incompatible with the pertinent obligations under a WTO agreement. As a second step, justifications for the prima facie illegal act have to be explored. The most important exceptions will be discussed throughout this book; they are not specific to the focus of this chapter.

In addition, GATT Articles I:2, I:3, and I:4 state certain exceptions to MFN based on historical trade arrangements that are today no longer relevant: For example, the United States is exempt from MFN with respect to trade preferences granted to its fellow WTO member Cuba.

Two specific, albeit minor exceptions to MFN deserve mentioning: GATT Article XIV, which permits discriminatory quotas, and Article IX:3 of the Agreement Establishing the World Trade Organization, which permits waivers of WTO obligations by a vote of a three-fourths majority of the WTO Ministerial Conference.

4.1.1 Quotas

As a general rule, quotas are subject to the MFN obligation when they are exceptionally permitted. In *EC—Bananas III*, the EC administered two separate import regimes for bananas, one for favoured ACP (African, Caribbean, and Pacific) countries and another for the rest of the world. The EC argued that the non-discrimination provisions of GATT Article I:1 (and Article XIII) applied separately to each regime. The WTO Panel, as well as the Appellate Body, disagreed, ruling that the non-discrimination obligation applied to the market for a product no matter how a member subdivides it for administrative reasons. The Appellate Body stated:

> Non-discrimination obligations apply to all imports of like products, except when these obligations are specifically waived or are otherwise not applicable as a result of the operation of specific provisions of the GATT 1994, such as Article XXIV. In the present case, the non-discrimination obligations of the GATT 1994, specifically Articles I:1 and XIII, apply fully to all imported bananas irrespective of their origin, except to the extent that these obligations are waived by the Lomé Waiver. We, therefore, uphold the findings of the Panel that the non-discrimination provisions of the GATT 1994, specifically, Articles I:1 and XIII, apply to the relevant EC regulations, irrespective if there is one or more "separate regimes" for the importation of bananas.[118]

An exception to this rule is GATT Article XIV, which permits discriminatory administration of quotas. Article XIV applies, however, only in the case where quotas are authorized because a member is experiencing balance of payment problems. Article XIV was intended to complement, in this regard, GATT Article XII and Article XVIII Section B, which authorize quotas for balance of payment reasons as exceptions to GATT Article XI:1. In such an exceptional case, discriminatory administration of quotas under Article XIII can be used so that a member experiencing balance of payments difficulties may target exports and imports to maximize its earnings and

[118] *EC—Bananas III* (Appellate Body), para. 191.

retention of convertible foreign currencies. Since the 1970s, however, trade quotas to correct balance of payments problems have become rare; the majority of WTO members, supported by the International Monetary Fund (IMF), now regards quotas as an 'inefficient means of correcting balance of payment problems'.[119] As a result, Article XIV has greatly receded in importance.

4.1.2 Waivers

Waivers of MFN are used sparingly and are approved primarily to benefit developing countries. For example, the Waiver Decision on Preferential Tariff Treatment for Least Developed Countries (the '1999 LDC Waiver')[120] allows developing countries to grant special preferences to least-developed countries under certain conditions until 30 June 2019.[121] It permits 'preferential tariff treatment'—as such incompatible with Article I:1—'provided on a generalized, non-reciprocal and non-discriminatory basis'.[122]

Thus, developed countries are permitted until 2019 'to provide such treatment to least-developed countries on a "non-discriminatory basis" under the 1999 LDC Waiver'.[123] To date, only one WTO member has notified its preferential tariff treatment for least-developed countries under the 1999 LDC Waiver.[124] In December 2011, the WTO Ministerial Conference adopted a waiver to enable developing and developed-country members to provide preferential treatment to services and service suppliers of least-developed countries (LDCs).[125]

However, two very important exceptions specifically undercut the most favoured nation approach enshrined in the GATT: (1) Preferential trade areas (GATT Article XXIV) and (2) special and differential treatment for developing countries. They receive significant attention elsewhere in this book (Chapters 14 and 19). Therefore only a brief overview is given.

4.2 Preferential trade areas (GATT Article XXIV and GATS Article V)

Customs unions and free trade agreements are specifically permitted under GATT Article XXIV in order to facilitate 'special relationships' between a sub-group (two or

[119] Decision, GATT B.I.S.D. 26S/205.

[120] WTO Waiver Decision on Preferential Tariff Treatment for Least-Developed Countries, WT/L/304, 15 June 1999.

[121] In May 2009 the waiver was extended until 30 June 2019; cf. General Council, Preferential Tariff Treatment for Least-developed Countries: Decision on Extension of Waiver, WT/L/759, 29 May 2009.

[122] Waiver Decision on Preferential Tariff Treatment for Least-Developed Countries, WT/L/304, 15 June 1999, para. 2.

[123] *EC—Tariff Preferences* (Appellate Body), para. 147, fn. 301.

[124] *WTO Analytical Index*, Vol. I, 125.

[125] cf. WT/L/847; the Bali Ministerial Conference further instructed members to put the waiver into operation WT/L/918. See also <https://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm>. Five developing countries, Chile (WT/COMTD/N/44), China (WT/COMTD/N/39 and WT/COMTD/N/39/Add.1/Rev.1), India (WT/COMTD/N/38), Republic of Korea (WT/COMTD/N/12/Rev.1 and WT/COMTD/N/12/Rev.1/Add.1), and Chinese Taipei (WT/COMTD/N/40), have notified their duty-free and quota-free schemes put in place in favour of LDCs. cf. WT/COMTD/W/206 of 26 November 2014.

more) of members. By their very nature and purpose these 'closer relations'[126] are not supposed to be shared with 'outsiders', that is, non-participants of those agreements. The number of FTAs/RTAs/PTAs[127] has increased sharply over the last decade; from an institutional WTO perspective PTAs are an exception to a core WTO obligation and only legal if the prerequisites of GATT Article XXIV and GATS Article V are being observed.

4.3 Special and differential treatment for developing countries (the Enabling Clause)

As an important exception to MFN and GATT Article I:1, developing countries may be accorded special and differential treatment: special (lower) tariff and other advantageous non-tariff benefits that do not have to be extended to other WTO members. The present source of this exemption is the so-called Enabling Clause, which was adopted by the GATT contracting parties on 28 November 1979 as a 'Decision on Differential and More Favourable Treatment and Fuller Participation of Developing Countries'[128] but has become an integral part of the WTO Agreement pursuant to paragraph 1 sub-paragraph b iv) of the Introductory Note to GATT 1994.[129] Chapter 19 of this book focuses on developing countries and the Enabling Clause; because the Enabling Clause intersects so dramatically with MFN, a brief overview of a landmark case in the area follows.

In *EC—Tariff Preferences*, the Appellate Body had to deal with the following scenario: India and Pakistan both benefited from the European Community's General System of Preferences. Pakistan, however, received additional preferences because it qualified under the so-called *Drug Arrangements*, a scheme aimed at compensating those WTO members adopting active policies against drug production and trafficking.[130]

The Appellate Body accepted that the Enabling Clause is an exception the MFN obligation of Article I:1, allowing *positive discrimination* in favour of developing countries. However, the principle of non-discrimination remains operational: developing countries are supposed to be treated in a non-discriminatory fashion by the developed members. The devil, of course, is in the detail: what does non-discriminatory mean? In the Appellate Body's view, paragraph 3(c) of the Enabling Clause allows developed members to help its developing trading partners *according to need*. As those needs vary as much as the developing countries are different from one another, differences in their treatment are justified, provided that the relevant tariff preferences respond positively to a particular 'development, financial or trade need' and are made available on the basis of an objective standard to 'all beneficiaries that share that need'.[131]

[126] cf. the Australia–New Zealand Closer Economic Relations Trade Agreement, <http://dfat.gov.au/trade/agreements/anzcerta/Pages/australia-new-zealand-closer-economic-relations-trade-agreement.aspx>.

[127] These acronyms stand for free trade agreements, regional trade agreements, and preferential trade agreements; these expressions and their acronyms are used interchangeably.

[128] GATT Document L/4903, B.I.S.D. 26S/203.

[129] *EC—Tariff Preferences* (Appellate Body), para. 90.

[130] *EC—Tariff Preferences* (Panel), para. 7.60.

[131] *EC—Tariff Preferences* (Appellate Body), paras. 162–4.

In granting such differential tariff treatment, however, preference-granting countries are required, by virtue of the term 'non-discriminatory', to ensure that identical treatment is available to all similarly situated GSP beneficiaries, that is, to all GSP beneficiaries that have the 'development, financial and trade needs' to which the treatment in question is intended to respond.[132]

Applying its test to the specific case, the Appellate Body found that the *Drug Arrangements* were not WTO-consistent, since the European Community laid down a closed list of beneficiaries.[133] For its scheme to be deemed WTO-consistent the EC, in the Appellate Body's view, had to adapt its GSP scheme so as to ensure that it reflects the criteria or standards to provide a basis for distinguishing beneficiaries under the *Drug Arrangements* from other GSP beneficiaries.[134]

Accordingly, WTO members can distinguish between recipients of preferences between developing countries, provided that they have established criteria to this effect. The Appellate Body thus allowed flexibility for those who want to cater to special needs, cautioning, however, that it would step in, should this flexibility be abused.

5. Conclusions

The administration of MFN today is paradoxical: while the standards for the application of MFN treatment are very strict, and the elements of MFN are all-encompassing— MFN applies to any advantage without exception and must be extended immediately and unconditionally— the broad exceptions to MFN for preferential trade agreements (and, to a much lesser extent, for developing countries) sharply restrict the scope and the actual importance of MFN.

MFN is becoming somewhat of an endangered species, as preferential trade arrangements now seem to attract all the attention of policy makers. At the time of writing negotiations are underway for a free trade agreement between the North Atlantic trade powers EU and US (TTIP);[135] between the EU and Japan; and between eleven Pacific nations, including Japan and the US (TPP).[136] If and when these free trade arrangements between some of the biggest world economies are added to the existing preferential trade arrangements, GATT Article I:1, once considered the cornerstone principle of international trade, will have been significantly weakened. Whereas a legal analysis of WTO law needs to analyse preferential trade as an 'exception' from the WTO MFN obligations, DC-FTAs[137] have become a second, more dynamic strand of international economic law. Even the term MFN has become somewhat a misnomer. For most WTO members, 'most favoured nation treatment' has become an (albeit important) default status. Whether the erosion of MFN is a satisfactory development or worrisome is a question that is yet to be answered.

[132] Ibid. para. 173. [133] Ibid. para. 187. [134] Ibid. para. 188.
[135] Transatlantic Trade and Investment Partnership, cf. <http://ec.europa.eu/trade/policy/in-focus/ttip/>.
[136] Trans-Pacific Partnership, cf. <https://ustr.gov/tpp>.
[137] Deep and Comprehensive Free Trade Agreements.

7

National Treatment

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1. National Treatment—A Recurring Theme in All WTO Agreements

The national treatment (NT) obligation is one of the two fundamental operational manifestations of the principle of non-discrimination, the other being the most favoured nation (MFN) obligation discussed in the previous chapter. National treatment means that a foreign person, product, or right—such as, for example, a good, a service, a service provider, an investor, an intellectual property right, or a (juridical or physical) person owning an (intellectual or other) property right—must be treated by a regulating state like their domestic ('national') equivalent. Such an obligation is

imaginable in a general and comprehensive fashion: All state measures affecting foreign persons, goods, services, or rights differently from their domestic enterprises and counterparts would be outlawed, including tariffs (i.e. duties to be paid *because of* the crossing of the border, cf. Chapter 8). Only *foreign* products trigger an obligation to pay an (import) tariff to access the domestic market, whereas domestic products may be introduced into the domestic market without prior payment of tariff duties.

As is well known, such a non-specific NT obligation does not exist in general international law. Even in modern, treaty-based, international economic law, the right to national treatment is regularly only triggered once the foreign good, service, right, or person has legally entered the market or territory of the host (or receiving) state.[1] Thus, NT is, *de lege lata*, conceptually linked to the full exposure to the jurisdiction of the regulating state, comparable to the situation of domestic products in their 'home' state.

With regard to trade in goods, the wording of GATT Article III makes this unequivocally clear as it speaks of 'imported' products that are not to be discriminated against. Only goods that have lawfully crossed the border (having been cleared by customs and by any other state agency that controls the entry of goods and persons) benefit from a right to equal treatment with the 'local' competition: what happens *before* a good legally enters the market (even when and if it is destined for importation) is beyond the reach of GATT Article III.[2]

The distinction between 'internal measures', that is, state measures applied after a completed importation (and subject to the disciplines of GATT Article III) and 'border measures', that is, measures applicable to foreign products *because* of their *crossing the border* for the purpose of entering the market (a scenario subject, inter alia, to GATT Article II) is a fundamental one, despite the fact that the terms 'border measure' and 'internal measure' do not appear in the text of the WTO Agreement.[3]

The central NT obligation with regard to goods can be found in GATT Article III. Before we look in depth at that provision, we provide a short overview of some other important NT provisions in WTO agreements.

1.1 National treatment in the TBT and SPS Agreements

The central NT obligation of the Agreement on Technical Barriers to Trade (TBT Agreement)[4] can be found in Article 2.1 which states that 'in respect of their technical

[1] Indeed, the NT clause has become a staple of any treaty in international economic law. See, for example, Canada–Chile Free Trade Agreement, 6 February 1997, 36 I.L.M. 1067, Art. 1-1-02; North American Free Trade Agreement, 17 December 1992, 32 I.L.M 289, Arts. 300–301. With regard to economic actors, national treatment is often accorded to the right of establishment, i.e. the right to set up subsidiaries and offices in another country.

[2] In GATT Panel report, *Italian Discrimination Against Imported Agricultural Machinery*, L/833, adopted 23 October 1958, B.I.S.D. 7S/60, para. 5, (hereinafter: *Italian Discrimination Against Imported Agricultural Machinery*), Art. III:4 was interpreted 'to provide equal conditions of competition once goods had been cleared through customs'. This is still good law.

[3] See later the discussion of Art. III:2; cf. *China—Auto Parts* (Appellate Body), paras. 161–3, 165; *India—Autos* (Panel), para. 7.306 *et seq.*; *Canada—FIRA* (Panel), para. 5.14.

[4] A comprehensive overview of this, and the SPS Agreement can be found in Chapter 13.

regulations, products imported from the territory of any Member be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country'.[5] Clearly, the drafters of the TBT Agreement wanted to consolidate both NT and MFN in one provision. Other NT obligations can be found, inter alia, in TBT Articles 5.1.1, 5.2.1, 5.2.5, and Annex 3 D.[6] Because of the obvious resemblance of TBT Article 2.1 and GATT Article III, the pertinent jurisprudence is always also relevant for the understanding of the respective sister provision.[7]

Similarly, the other important standard-related WTO agreement, the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) also contains several NT obligations; the central provision is SPS Agreement Article 2.3, according to which

> Members shall ensure that their sanitary and phytosanitary measures do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail, including between their own territory and that of other Members. Sanitary and phytosanitary measures shall not be applied in a manner which would constitute a disguised restriction on international trade.

Annex C, paragraph 1(a) of the SPS Agreement[8] requires that members 'ensure, with respect to any procedure to check and ensure the fulfilment of sanitary or phytosanitary measures, that such procedures are undertaken and completed without delay and in no less favourable manner for imported products than for like domestic products'.

1.2 National treatment in the GATS

GATS Article XVII addresses national treatment for services:

1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.
2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.

[5] The leading cases are *US—COOL*, *US—Tuna II*, and *US—Clove Cigarettes*; cf. in detail Chapter 13.

[6] Art. 5.1.1 of the TBT Agreement requires with regard to conformity assessment procedures that they shall be applied to imported products 'under conditions no less favourable than those accorded to suppliers of like products of national origin or originating in any other country'. Also, members must respect the confidentiality of the information about the result of the conformity assessment procedures for imported products in the same way as for domestic products so that commercial interests are protected (Arts. 5.2.4 and 5.2.5).

[7] *US—COOL* (Appellate Body), para. 270.

[8] This provision deals with 'Control, inspection and approval procedures' and includes, according in its fn. 7 '*inter alia*, procedures for sampling, testing and certification'.

3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

The last paragraph explicitly lays down what had been established prior to the establishment of the WTO by GATT 1947 jurisprudence. National treatment is about the importing state *not* modifying, in law or in fact, the conditions of competition in favour of their own service industry. Note, however, that this far-reaching obligation is not the state of play for many, if not most WTO members with regard to services. The reason for this will be discussed in detail in Chapter 16. For the moment, we limit ourselves to drawing the readers' attention to the fact that the GATS NT obligation is not a *general* obligation but rather comes into play only if a member has bound itself *specifically* to extend national treatment to its trading partners by including that commitment in its 'schedule of specific commitments'.[9]

1.3 National treatment in the TRIPs Agreement

National treatment had long been a feature of intellectual property conventions. In the context of the implementation of national or international intellectual property laws or regulations, Article 3 of the TRIPs Agreement prohibits treatment of foreign nationals on less favourable terms than those accorded to nationals.[10] Parallel obligations are found in the Paris Convention,[11] the Berne Convention,[12] the Rome Convention,[13] and the Treaty on Intellectual Property in Respect of Integrated Circuits which are incorporated by reference into TRIPs Articles 1 and 3.[14]

2. National Treatment Pursuant to GATT Article III

The remainder of this chapter is dedicated to the general NT obligation in GATT, enshrined in its Article III. The objective is to allow the reader to grasp the function of GATT Article III and in particular its current relevance in WTO law. This chapter will, however, refrain from sketching the historic development of the jurisprudence in detail.[15] Rather, an attempt will be made to distil the state of play out of sometimes not completely easy to reconcile findings and *obiter dicta.* We shall also refrain here from fully engaging in the rich scholarly debate about the purpose of Article III.[16]

[9] GATS Art. XVII.

[10] *US—Section 211 Appropriations Act* (Appellate Body), paras. 242–3.

[11] The Paris Convention for the Protection of Industrial Property (1967).

[12] The Berne Convention for the Protection of Literary and Artistic Works (1971).

[13] The International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations (1961).

[14] All these treaties are administered by the World Intellectual Property Organization (WIPO) and easily accessible on the excellent website of this international organization, <http://www.wipo.int/treaties/en/>.

[15] For this history, see Michael Trebilcock, Robert L. Howse, and Antonia Eliason, *International Trade Regulation*, 4th edn. (Routledge, 2013).

[16] cf. Petros C. Mavroidis, *Trade in Goods*, 2nd edn. (Oxford University Press, 2012) 300–8, with further references.

Before we turn to a detailed analysis of the three operative provisions that GATT Article III contains, some general remarks seem appropriate in order to better understand the scope and ongoing relevance of the national treatment clause.

2.1 A broad protection against discriminatory and protectionist internal measures

According to GATT Article III, no law, regulation, or taxation pattern may adversely modify the conditions of competition between like imported and domestic products in the domestic market.[17] The broad wording—which shall be discussed in detail later in this chapter—ensures that both measures favouring domestic products and measures disfavouring like imported product are covered. As a consequence, Article III 'obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products',[18] thereby protecting 'expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties'; however, actual trade volumes are not protected by GATT Article III. Therefore, a discriminatory measure having no demonstrable effect (yet) does not preclude a successful claim that Article III has been violated: As Article III protects 'the predictability needed to plan future trade',[19] it captures both actual and potential,[20] both direct and indirect,[21] and both de jure (example: only buyers of *domestic* cars will receive a subsidy or a tax break)[22] and formally even-handed, but de facto discriminatory measures[23] that disproportionally affect foreign goods (hypothetical example: distilled spirits are taxed at the regular VAT rate, as long as their alcohol content is below 36 per cent alcohol-by-volume (*ABV*); beyond that level, the applicable rate is twice the VAT rate. Foreign distilled spirits all show 37 per cent *ABV*,

[17] *Italian Discrimination Against Imported Agricultural Machinery*, n. 2 at 60, para. 12 (invalidating Italian law providing low-interest loans to purchasers of Italian-made tractors).

[18] cf. the Appellate Body's statement in *Japan—Alcoholic Beverages*, 16–17; see also *US—Taxes on Petroleum and Certain Imported Substances* (GATT 1947 Panel), para. 5.2.2.

[19] GATT Panel report, *US—Taxes on Petroleum and Certain Imported Substances*, L/6175, adopted 17 June 1987, B.I.S.D. 34S/136, para. 5.2.2 (hereinafter: *US—Superfund*).

[20] See, for example, *Canada—Autos* (Panel), para. 10.80: 'The word "affecting" in Article III:4 . . . has been interpreted to cover not only laws and regulations which directly govern the conditions of sale and purchase but also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products'.

[21] cf. the Appellate Body's statement in *Japan—Alcoholic Beverages II* (sub. F.), 16–17, that 'it is *irrelevant that "the trade effects"* of the tax differential between imported and domestic products, as reflected in the volumes of imports, *are insignificant or even non-existent*; Article III protects *expectations* not of any particular trade volume but rather *of the equal competitive relationship* between imported and domestic products' (emphasis added). Thus, indirect and potential effect must suffice. cf., with regard to Art. 34 TFUE, Case C-8/74 *Procureur du Roi v Benoit and Gustave Dassonville* [1974] ECR 837.

[22] cf. from the jurisprudence *Korea—Various Measures on Beef*, where the different points of sale were defined by the origin of the products.

[23] GATS Art. XVII:3, drawing on pertinent pre-WTO GATT jurisprudence, *explicitly* includes de facto discrimination in its regulatory mission statement: 'Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.'

whereas domestic ones are traditionally at 35 per cent *ABV*).[24] Also, it is no valid excuse for a discriminatory measure that it is not being enforced or applied.[25]

When the GATT was drafted, the *immediate* purpose of GATT Article III was to pre-empt a *nullification by circumvention* of benefits resulting from tariff concessions granted under GATT Article II. The intended lowering of tariffs (that took place, as intended, from 1947 on as a consequence of the ensuing trade rounds) facilitates market access by foreign competitors. Foreseeably, the importing state (lobbied by the affected domestic industry) may be tempted to alleviate the painful competitive pressure on its domestic industries by undoing the effects of increased market penetration by employing some discriminatory measures. Obviously, such behaviour would run against the very purpose of tariff reductions: they are supposed to facilitate (reciprocal) market access by reducing the 'price of entry' for imported goods. Also, readers should keep in mind that no tariff reduction has ever come about as a consequence of the conviction of decision makers that lowering tariff barriers was a mutually beneficial state policy (which the economists assure it is). Rather, each and every tariff reduction has been 'paid for' by granting reciprocal trade benefits.

However, the historical *raison d'être* of GATT's NT provision does not limit its function to safeguarding tariff commitments. Rather, it is well-established practice under GATT and WTO law that the purpose of GATT Article III transcends the protection of negotiated tariff deals:[26] Article III is supposed to avoid *any* protectionist measures by a member, and thus protects (in a legally binding fashion) the expectation that once a good has passed the tariff barriers surrounding members' markets (which legitimately protect the domestic industries), it will be free from *internal* state measures that render it less competitive. In this sense,

> the "general principle" in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, *between the domestic and imported products involved*, "so as to afford protection to domestic production."[27]

To use the words of a GATT Panel, Article III aims at providing 'effective equality of opportunity for imported products'.[28] In order to achieve this, it covers virtually any measure influencing the competitive relationship between domestic products and (legally) imported products; this includes products for which no tariff commitments (GATT Article II:7) have been entered.[29]

[24] cf. from the jurisprudence the classic *Alcoholic Beverages* cases (in both WTO and EU law, it should be mentioned), where the pertinent de facto discriminatory measures are always formally even-handed.

[25] See, for example, GATT Panel report, *US Section 337 of the Tariff Act of 1930*, L/6439, adopted 7 November 1989, B.I.S.D. 36S/345, para. 5.13 (hereinafter: *US—Section 337 Tariff Act*) (taking the approach that establishing whether the 'no less favourable' treatment standard of Art. III is met requires an assessment of whether the law, regulation, or requirement in question may itself lead to the application to imported products of treatment less favourable than that accorded to domestic products); *US—Superfund*, n. 19 at paras. 5.2.1–5.2.2.

[26] Ibid. para. 5.2.2.

[27] *EC—Asbestos* (Appellate Body), para. 98 (emphasis in the original).

[28] *US—Section 337 Tariff Act*, n. 25, para. 5.11; *Japan—Alcoholic Beverages II* (Appellate Body), 16–17.

[29] Working Party report, *Brazilian Internal Taxes*, GATT/CP.3/42 (First Report), adopted 30 June 1949, B.I.S.D. II/181, para. 4 (concluding that a GATT contracting party was bound by Art. III (i.e. the NT

2.2 Protection against state measures vs. preservation of members' regulatory autonomy

GATT Article III covers—as is immediately apparent from the wording of GATT Article III:1—(1) internal taxes and charges; (2) laws, regulations, and requirements affecting the sale, transportation, distribution, or use of products; and (3) internal quantitative regulations requiring the mixture, processing, or use of products in specified amounts or proportions. Each of these three matters is dealt with more specifically in subsequent paragraphs of Article III. However, the Appellate Body has rightly highlighted that Article III:1 states the 'general principle' of the NT provision which 'informs' the remainder of Article III.[30]

This very broad coverage—for all practical purposes GATT Article III captures all (internal) state measures that have an effect on the competitive position of foreign goods[31]—entails the risk that NT becomes a tool to undo all sorts of domestic policy choices that favour or disfavour certain goods as a consequence of legitimate government policies. Examples coming to mind would include measures encouraging energy savings, or reducing the consumption of alcohol or other goods that may be detrimental for human health or may create costs which affect the state directly[32] or indirectly.[33] If that risk materializes, the command *not to discriminate* could unduly limit the exercise of legitimate public choices, and force, for example, the environmentally conscious member to treat gas-guzzling SUVs 'no less favourably than' hybrid cars, or oblige it to apply the (low) sales tax it had previewed for low-alcohol beer also to the 'high-octane' beer variety that creates higher societal costs and which was therefore supposed to be priced out of the market.

Such a result would seem highly problematic: it is not, nor should it be (in the absence of any pertinent will of the sovereign members expressed in the Agreement) the purpose of WTO law to shape, for example, environmental or public health policy choices (to stick with the examples just given). And indeed, due to two variables in the wording of GATT Article III—'like product' and the command to not grant less advantageous treatment[34]—the degree of intrusion into the states' sphere to determine for themselves their public policy is somewhat reduced, as the obligation of a member to treat foreign

obligation) regardless of whether the contracting party in question 'had undertaken tariff commitments in respect of the goods concerned').

[30] *Japan—Alcoholic Beverages II* (Appellate Body), 18.

[31] Including direct taxes that may have an effect on the competitive position of foreign goods, such as rules on the deductibility of certain business expenses. cf. the wording of the provision: 'The products of the territory of any contracting party imported into the territory of any other contracting party *shall not be subject, directly or indirectly, to internal taxes*... in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.'

[32] For example, through expenditure on health care.

[33] For example, costs that affect the viability of a domestic industry or the domestic economy which affects, in turn, both state finances and attractiveness.

[34] In GATT Art. III:2 'shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products' and in GATT Article III:4 'shall be accorded treatment no less favourable than that accorded to like products of national origin'.

products 'no less favourably' than domestic ones only exists with regard to (somewhat) *equivalent domestic counterparts*. If a category of goods is subjected by a member to an unfavourable tax or regulatory treatment (without being incompatible with other legal obligations of the member, resulting for example from the SPS Agreement or GATT Article II), this treatment establishes the standard of treatment that can be applied to both domestic and imported products. Whatever the reason for the specific state measures are—for example, efforts to reduce consumption (alcohol, fuel, water) or efforts to increase state revenue (for example, by higher VAT on certain product categories)—the member, owes only that (possibly unfavourable) treatment to the imported product. The member, however, must not extend *more* unfavourable (in other words: must not practise less favourable) treatment with regard to the imported product.

The devil is, of course, in the detail: How is less favourable treatment to be determined? When is it appropriate to assume that a product is 'like' or 'directly competitive and substitutable'? If an apple (grown on the tree that Grandpa planted) and a laboratory-produced cell-cluster (which looks like an apple, tastes like an apple, and smells like an apple) *are* indeed, as a matter of WTO law, 'like' for the purposes of Article III, the political choice of a country to disallow the use of that technology—for religious reasons, say—will be disregarded by WTO law.[35] Difficult questions like these have accompanied both the scholarly discussion and the jurisprudence.

A second parameter should protect against NT becoming an undesirable intrusion into members' regulatory space. Article III:1, the leitmotiv of the national treatment clause, makes clear that the differential treatment should not be undertaken 'so as to afford protection to domestic production'. Therefore, government policies that have no relation to affording 'protection to domestic production' should be left unaffected by Article III intrusion.[36]

2.2.1 The aim and effects test

It was this latter insight that led Panels to develop the aims and effects test. In a nutshell, it aspired to exclude from the Article III catchment area measures that had neither the purpose nor the effect of subjecting imported products to protectionist discrimination, but rather were a legitimate, reasonable, and even-handed pursuit of legitimate state functions. Whilst the Appellate Body has declared this test baseless and erroneous,[37] it would seem that its demise has been less complete that one would think when reading the pertinent Appellate Body report.

In *Malt Beverages*, Canada had challenged certain US state and federal taxes and sales regulations that resulted in differential treatment of domestic and imported alcoholic beverages.[38] One measure challenged was a Mississippi wine tax imposing a lower tax rate on wines made from a certain grape variety. The Panel concluded that

[35] Note that modern WTO agreements such as the SPS and the TBT Agreements harmonize acceptable state behaviour to a certain point; for example, certain measures must be science-based to be legally acceptable.

[36] Recently, the Appellate Body has required 'a genuine relationship': *Thailand—Cigarettes (Philippines)* (Appellate Body), para. 134.

[37] *Japan—Alcoholic Beverages II* (Appellate Body), 27–8.

[38] GATT Panel report, *US—Measures Affecting Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992, B.I.S.D. 39S/206 (here in after: *US—Malt Beverages*).

there was no other public policy purpose for taxing two types of wine differently than protecting local producers.[39] Accordingly, the wine tax was found to be inconsistent with GATT Article III.[40] Challenges were also directed against several state restrictions on the sale of beer that differentiated according to the respective alcohol content. The Panel concluded that low alcohol content beer and high alcohol content beer 'need not be considered as like products,' because the purpose of the restrictions was to encourage consumption of low alcohol content beer; the restrictions did not create adverse conditions of competition for Canadian producers.[41] Thus, the Panel used the declared purpose of GATT Article III:1—to (only) disallow policies that are destined to afford protection—to limit the notion of 'like products' to constellations in which the state measure was in violation of that overarching goal. This argumentation was taken up and somewhat refined in *US—Taxes on Automobiles*.[42]

> 5.10 The Panel then proceeded to examine . . . the meaning of the phrase "so as to afford protection". The Panel noted that the term "so as to" suggested both aim and effect. . . . A measure could be said to have the *aim* of affording protection if an analysis of the circumstances in which it was adopted, in particular an analysis of the instruments available to the contracting party to achieve the declared domestic policy goal, demonstrated that a change in competitive opportunities in favor of domestic products was a desired outcome and not merely an incidental consequence of the pursuit of a legitimate policy goal. A measure could be said to have the *effect* of affording protection to domestic production if it accorded greater competitive opportunities to domestic products than to imported products. . . .
>
> 5.13 The Panel then considered whether the threshold distinction in the luxury tax had the *effect*, in terms of conditions of competition, of affording protection to domestic production. . . . The Panel did not find that the sales data provided conclusive evidence of a change in the conditions of competition favouring United States automobiles. . . .
>
> 5.14 The Panel then considered whether there was evidence, other than sales or tradeflow data, that the threshold had the effect, in terms of conditions of competition, of affording protection to domestic automobiles. . . . [T]ogether with the fact that the threshold did not appear arbitrary or contrived in the context of the policies pursued, . . . the dominant presence at a particular time of the EC cars in the sector of the market affected by the measure could not be taken as evidence of a discriminatory effect.

The Panel upheld US luxury and 'gas guzzler' taxes on cars, despite their dissimilar effect on imported vehicles, as it saw neither a protective aim nor an effect on the conditions of competition.[43] It recognized the US measure as a fully legitimate policy

[39] Ibid. para. 5.26.

[40] Ibid. Of course one would today also think of cultural diversity as a motivation to protect 'shelf space' for locally made wine, featuring a grape variety unique to North America.

[41] *US—Malt Beverages*, n. 38, paras. 5.75–5.76.

[42] GATT Panel report, *US—Taxes on Automobiles*, DS31/R, 11 October 1994, unadopted, para. 5.10 *et seq.*

[43] Ibid. para. 5.15. The issue of protective effect was analysed, not in terms of actual sales data, but on the basis of *potential* effect. Ibid. para. 5.14. The Panel noted that there was no evidence that foreign manufacturers lacked inherent capacity to market automobiles below the high tax thresholds. Ibid. The Panel also found that the US corporate average fuel efficiency rules were in violation of Art. III:4 because certain averaging formulas discriminated against foreign vehicles. Ibid. para. 5.55.

choice for non-protectionist purposes. As to the issue of protective effect, the Panel analysed the issue not by drawing inferences from the actual sales data as such, but by examining the effect of conditions of competition.[44]

While the Appellate Body rejected the 'aim and effects test' in *Japan—Alcoholic Beverages II*[45] for lack of a textual basis, the issue of preserving policy space for the national decision-makers is now being addressed by the Appellate Body elsewhere. As this book follows the Appellate Body's view on the structure of Article III in order to acquaint the reader with the state of play of the case law, the issue will be discussed when and where the Appellate Body addresses it, most notably in GATT Article III:2(2) and III:4. However, some context seems appropriate at this point.

The rejection of the aim and effects approach[46] would seem to have been motivated more by the wish to avoid intrusive inquiries into the inner workings of the decision-making procedures in the heterogeneous membership—which includes absolute monarchies, communist dictatorships, military governments, one-party regimes, and Western-style democracies—rather than by wishing to disregard the importance of the underlying recognition that certain state measures are non-protectionist and should therefore normally be 'left alone' by the disciplines of Article III—and the evaluation of the Appellate Body. It is with this perspective that one should take note of the Appellate Body's emphasis of the irrelevance of intent and the decisiveness of the 'objective application' of the measure at issue.[47] This being said, the Appellate Body will take note of evidence showing an intention to discriminate.[48] Hence, the measure will, of course, have to be analysed with regard to (potential) effect.[49] However, the Appellate Body will also undertake to distil the *objective aim* of a measure in order to determine whether the measure is applied in a manner 'so as to afford protection to domestic production' within the meaning of Article III:2, second sentence. In *Philippines—Distilled Spirits*, the Appellate Body summarized the applicable test as follows:

> This requires a "comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products". The Appellate Body observed that, "[a]lthough it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure." The Appellate Body further stated that dissimilar taxation must be more than *de minimis*, and that in certain cases "[t]he very magnitude of the dissimilar taxation…

44 *US—Taxes on Automobiles* failed to receive endorsement by the contracting parties.

45 More specifically, it upheld the Panel report's findings at paras 6.16–6.17, cf. *Japan—Alcoholic Beverages II* (Appellate Body), 25. For an excellent analysis, see Robert E. Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test' (1998) *The International Lawyer* 32(3), 619, 630.

46 The rejection of a purpose inquiry was reaffirmed by the Appellate Body in *European Communities—Bananas*: the 'so as to afford protection' language of Art. III:1 is not incorporated or referred to in Art. III:4; *EC—Bananas III* (Appellate Body), paras. 215–16.

47 *Japan—Alcoholic Beverages II* (Appellate Body), 29. See also *Korea—Alcoholic Beverages* (Appellate Body), para. 149; *Philippines—Distilled Spirits* (Appellate Body), para. 250.

48 See, for example, *Canada—Periodicals* (Appellate Body), 25 *et seq.*

49 *China—Publications and Audiovisual Products* (Panel), para. 7.1471 ('may reasonably be expected'); but see *Thailand—Cigarettes* (Appellate Body), para. 134.

> may be evidence of such a protective application."[50] In *Korea—Alcoholic Beverages*,[51] the Appellate Body added that the protective application of dissimilar taxation can only be determined "on a case-by-case basis, taking account of all relevant facts".[52]

The late Robert Hudec criticized this approach:

> The Appellate Body's responses to these various efforts to employ an "aim and effects" approach suggests an unusually strict attachment to the exact words of the relevant GATT or GATS provisions. One might understand such textual literalism in defense of legal criteria believed to be correct and appropriate, but it is disappointing to see the Appellate Body following such a literalist approach when it results in extending the empty formalism of the traditional "like product" analysis. The disappointment becomes even greater when it is recognized that the issues in these cases go to the very core of the WTO's policing function over domestic regulatory policy—in some respects the most important element of its legal character. We know from the experience of the United States Supreme Court and the European Court of Justice, both of whom are called upon to make very similar rulings, that these are extremely sensitive and difficult issues. Developing an accepted and effective jurisprudence in this area requires a high degree of sensitivity to the balance of the interests involved, and a high degree of creativity in fashioning answers that provide a satisfactory balance. It is not encouraging to think that the Appellate Body has launched itself upon this delicate and sensitive task bound hand and foot to the words of an old, and often badly drafted, instrument.[53]

Some of the concerns expressed by Hudec and others have been taken on board. There is no doubt that since the *Asbestos* case, the Appellate Body has moved much closer to a *rule of reason* approach (certain trade-impeding state measures may be justified as reasonable, non-protectionist manifestation of legitimate non-trade policies, and do not constitute a violation of WTO law) than when Robert Hudec wrote his remarks.[54] In the context of the more modern non-discrimination clause of the TBT Agreement, the Appellate Body has recognized the notion of legitimate regulatory distinction:[55] If a legitimate political choice is the sole reason for a measure that has an undesirable effect on a foreign product, this will not be considered discriminatory provided it is the principal reason and the measure is in itself not discriminatory and not disproportionate.[56] While this jurisprudence was motivated by the absence of a counterpart provision of GATT Article XX, it is very much reminiscent of the aims and effects test.

[50] Ibid. [51] *Korea—Alcoholic Beverages* (Appellate Body), para. 137.

[52] *Philippines—Taxes on Distilled Spirits* (Appellate Body), para. 250.

[53] Hudec, 'GATT/WTO Constraints on National Regulation', (n. 45) at 633.

[54] Of course, the term rule of reason has been coined in the context of the European Union's case law on what kind of state measures constitute a (protectionist) infringement on the free movement of goods protected by the TFEU.

[55] *US—COOL* (Appellate Body), para. 271 '. . . some technical regulations that have a *de facto* detrimental impact on imports may not be inconsistent with [TBT] Article 2.1 when such impact stems exclusively from a legitimate regulatory distinction. In contrast, where a regulatory distinction is not designed and applied in an even handed manner—because, for example, it is designed or applied in a manner that constitutes a means of arbitrary or unjustifiable discrimination—that distinction cannot be considered "legitimate", and thus the detrimental impact will reflect discrimination prohibited under Article 2.1.'

[56] cf., inter alia, Gabrielle Marceau and Joel P. Trachtman, 'A Map of the World Trade Organization Law of Domestic Regulation of Goods: The Technical Barriers to Trade Agreement, the Sanitary and

2.2.2 'Likeness' and the product–process distinction

GATT jurisprudence with respect to Article III has been characterized by the near complete refusal to allow a product's conditions of production (notably the social, labour, and environmental conditions of production) per se as a criterion for determining 'likeness' or, rather, 'unlikeness'. The determination of 'likeness' 'is, fundamentally, a determination about the nature and the extent of a competitive relationship between and among imported and domestic products'.[57] By implication, it is therefore not a value judgement of the political, social, or eco-compatible environment in which the production takes place. That is sub-optimal for the advancement of concerns such as economic justice and environmental sustainability. But it may be—regrettable as this may seem—that this is the *conditio sine qua non* for a legal regime that covers economic intercourse between 161 states with wildly different value systems and political priorities.

This was and remains the fundament for what one may call a bright-line distinction between the product as such and the process or production methods (PPM) used to generate it.[58] However, battle lines have somewhat changed. The reluctance to bring the PPMs within the realm of Article III analysis[59] seems influenced in equal parts by principle and pragmatism: the GATT and indeed all WTO agreements deal with international commerce. By looking only at economic interchanges and excluding from its coverage state measures that concern the conditions of production (unless specifically covered, such as subsidies), the GATT became the efficient environment for international trade regulations that it is today. Changing that by including an examination of the conditions of production opens the system for clearly non-economic concerns and actors. States remain reluctant to allow these concerns and actors to be dealt with by an efficient treaty mechanism with strong dispute settlement procedures.[60]

So far, state measures affecting the production of goods are *as such* only targeted by the GATT when they have a fairly immediate impact on commerce. Other areas of international law and policy (such as human rights in general, labour rights, environmental obligations) are not part of the mandate of the WTO, nor are they

Phytosanitary Measures Agreement, and the General Agreement on Tariffs and Trade' (2014) *Journal of World Trade* 48, (2) 351–432, at 358 *et seq.*

[57] *Philippines—Distilled Spirits* (Appellate Body), para. 170.

[58] See Christiane R. Conrad, *Processes and Production Methods (PPMs) in WTO Law, Interfacing Trade and Social Goals* (Cambridge University Press, 2011) and GATT Panel report, *US—Restrictions on Imports of Tuna*, DS21/R, 3 September 1991, unadopted, B.I.S.D. 39S/155, para. 5.11 (hereinafter: *US—Tuna (Mexico)*); GATT Panel report, *US—Restrictions on Imports of Tuna*, DS29/R, 16 June 1994, unadopted, paras. 5.8–5.9 (hereinafter: *US—Tuna (EEC)*); see also *US—Malt Beverages,* n. 38; and *US—Taxes on Automobiles*, n. 42. Two WTO Panel decisions discussed the product–process distinction with approval, although in neither case did the Appellate Body expressly rule on it. See *US—Gasoline* (Panel), paras. 6.11–6.13; *Canada—Periodicals* (Panel), paras. 5.24–5.25.

[59] Heavily criticized by scholarly writers such as Ernst-Ulrich Petersmann, *International Economic Law in the 21st Century: Constitutional Pluralism and Multilevel Governance of Interdependent Public Goods* (Oxford: Hart Publishing, 2012); Robert Howse and Donald Regan, 'The Product/Process Distinction—An Illusory Basis for Disciplining Unilateralism' (2000) *European Journal of International Law* 11, 249; Steve Charnovitz, 'The Law of Environmental "PPMs" in the WTO: Debunking the Myth of Illegality' (2000) *Yale Journal of International Law* 27, 59.

[60] Testimony for this point is the somewhat limited effect of the discussions in the WTO Trade and Environment Committee; see Chapter 20.

subjected—outside of regional arrangements[61]—to efficient international regimes. From a pragmatic WTO perspective, overstepping those boundaries might present an existential threat to the system. It seems systemically destabilizing to upset some of the old and all of the new trading powers to accept more far-reaching, procedurally enforceable legal positions than they were ever prepared to accept in the fora which should have the lead in those matters.[62] Despite their heterogeneous political structures and beliefs, many members are united in their rejection of linking trade and justice-related issues.[63]

Hence, the scope of applicability of the Article III national treatment obligation has been held to be limited to measures applying to or affecting the characteristics of the product itself. For example, in *Tuna Dolphin I*, the Panel ruled that the import ban on tuna caught with dolphin-killing methods was not within the scope of Article III because '[r]egulations governing the taking of dolphins incidental to the taking of tuna could not possibly affect *tuna as a product*'.[64]

However, the determination of likeness follows, according to established WTO case law, a multi-pronged test which includes *consumer tastes and preferences*. Consumers may find certain PPMs relevant enough to find an otherwise perfectly substitutable product 'unlike'. To give an example: In many markets, consumers are highly interested in knowing whether meat for sale is *kosher* or *halal*. Meat that would not satisfy those religious standards (which are *also* PPMs) would never find its way on to certain dinner tables. In other markets, consumers would be reluctant to buy meat from animals not treated without 'full regard to the welfare requirements of animals'[65] and fed according to organic standards. In still other markets, consumers may care about the social and labour conditions of the workers producing certain goods. Whether the fancy shirt is produced by inhumanly treated, bonded labour or rather by a well-paid workforce, may affect the 'wearability' of the product. It is not difficult to imagine markets in which none of those differences would matter to the consumer: in some markets, a steak is a steak, and a shirt is a shirt. Thus, the relevance of those differences for the market will drastically vary from market to market and require to be examined on a case-by-case basis.[66]

Also, nothing in present-day tariff law prevents members from establishing separate tariff lines for products generated in a certain way, for example a separate tariff line for organically produced bovine meat (or certain cuts thereof); such a practice is not common though. As tariff categories have also been used by the Appellate Body to determine likeness, three of the most commonly used four criteria for determining likeness may indirectly bring PPMs into the equation. The interpretation of 'like' product under Article III:4 permits differentiation based on the way a product is

[61] Such as the TFEU or some bilateral FTAs containing strong side agreements linking trade liberalization and labour rights or the environment protection measures.

[62] Compare the weak dispute settlement provisions in environmental agreements or the UNESCO Diversity Convention with the WTO's dispute settlement mechanism.

[63] For the position of the EU cf. Chapter 3.

[64] *US—Tuna (Mexico)*, n. 58 at para. 5.15 (emphasis added).

[65] cf. TFEU Art. 13.

[66] cf. Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization*, 3rd edn. (Cambridge University Press, 2013) 393.

made, produced, or harvested to the extent that these differences are captured by the existing criteria to determine likeness (*Border Tax Adjustment* criteria),[67] which are, according to the Appellate Body, not a closed list.

2.2.3 GATT Article III: more than the sum of its constituent parts…

GATT Article III is structured into several paragraphs. Paragraph 1 lays down the very purpose of the provision,[68] paragraph 2 breaks the principle down into an operative provision regarding *taxes*, and paragraph 4 contains the operative provision with regard to all state measures (other than tax measures). The remaining paragraphs contain either more specific applications or exceptions. This reading of Article III and in particular of the relationship between paragraph 1 and the remainder of Article III was established in *Japan—Alcoholic Beverages II* and refined in *Korea—Alcoholic Beverages* and *Chile—Alcoholic Beverages*.[69] Paragraph 1 was held to not be an operative provision but rather to lay down the general principle and purpose of the national treatment clause.[70] However, it would become operational to the extent that other paragraphs specifically refer back to it, as is, in the Appellate Body's view, the case in Article III:2, sentence 2.

Paragraph 2 is seen by the Appellate Body as containing two different standards for measuring whether internal taxes or other internal charges comply with GATT.[71] Panels have to address initially whether the standard contained in Article III:2, sentence 1 has been met, which requires any member to not tax 'like' imported products 'in excess of' their domestic counterpart. If one of these two conditions has not been fulfilled, the Panel has to subsequently address whether the taxation of 'directly competitive or substitutable products' meets the requirements of GATT Article III:2, sentence 2.[72] The category of 'directly competitive or substitutable products' is, according to the Appellate Body, broader than 'like products': like products are seen as a (more strictly regulated) subgroup of 'directly competitive or substitutable product': apples might, for example, be 'like' apples, and 'unlike' pears, but—depending on a case-by-case analysis—may still be in a directly competitive or substitutable relationship with pears.[73] However, as Article III:2, sentence 2 refers explicitly to Article III:1, the Appellate Body views as a third element of the test for Article III:2, sentence 2

[67] Report of the Working Party adopted on 2 December 1970, (L/3464), B.I.S.D. 18S/97.

[68] *Japan—Alcoholic Beverages II* (Appellate Body), DSR 1996:I, 97 at 111; *EC—Asbestos* (Appellate Body), para. 93.

[69] *Japan—Alcoholic Beverages II* (Appellate Body); *Korea—Alcoholic Beverages* (Appellate Body); *Chile—Alcoholic Beverages* (Appellate Body).

[70] *Japan—Alcoholic Beverages II* (Appellate Body), 18, DSR 1996:I, 97 at 111: 'In short, Article III:1 constitutes part of the context of Article III:2, in the same way that it constitutes part of the context of each of the other paragraphs in Article III. Any other reading of Article III would have the effect of rendering the words of Article III:1 meaningless, thereby violating the fundamental principle of effectiveness in treaty interpretation. Consistent with this principle of effectiveness, and with the textual differences in the two sentences, we believe that Article III:1 informs the first sentence and the second sentence of Article III:2 in different ways.'

[71] *Japan—Alcoholic Beverages II* (Appellate Body), 19; *Indonesia—Autos* (Panel), para. 14.103.

[72] *Canada—Periodicals* (Appellate Body), 22 *et seq.*

[73] cf. *Japan—Alcoholic Beverages II* (Appellate Body), 25; *Canada—Periodicals* (Appellate Body), 28; *Korea—Alcoholic Beverages* (Appellate Body), para. 118.

the analysis of whether a measure is 'contrary to the principles set forth in paragraph 1' and develops criteria on how to determine this opposition to the fundamental principles of Article III:1.[74] Finally, paragraph 4 is a straightforward stand-alone regulation, 'informed',[75] however, by paragraph 1 and its declared purpose and function.

3. Article III:2—Internal Taxation

Article III:2 requires members to provide national treatment to foreign products with respect to internal taxes. It reads:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

Whereas GATT Article II establishes the instruments to 'bind' a member's tariff rates towards the membership, internal taxes—that is, charges imposed unilaterally by the state that are not the consideration (a quid pro quo) for a service rendered—are not 'bound' by the GATT. Some members have extremely high taxes, others have a zero tax policy. However, GATT Article III:2 mandates that taxes have to be applied on a non-discriminatory basis to both domestic and like imported products originating in other WTO members.[76]

3.1 Scope

Case law confirms what the wording of Article III:2 indicates rather clearly: the disciplines of GATT's NT provision do not apply to tariffs and other charges imposed on or in connection with the importation or exportation of products.[77] As already indicated, Article III applies only to 'imported goods', not to 'goods' or 'goods destined for importation'. A legal text defining the rights and obligations of sovereign states with regard to trans-boundary commerce will not refer to an '*imported* good' as a mere factual description of a good having reached the domestic market of a member (or else contraband cigarettes would be 'imported' for the purposes of Article III). Rather, 'imported good' must mean 'a good that has been cleared by customs, meaning in particular that pertinent custom duties and other levies have been paid for'.[78] In addition, the interpretive note *ad* Article III provides that

[74] *Japan—Alcoholic Beverages II* (Appellate Body), 27. [75] Ibid.

[76] In *Indonesia—Autos*, the Panel found that tax provisions of the National Car Program violated GATT Art. III:2, because like products (imported vehicles and national vehicles with the same end-uses, basic properties, nature, and quality) were taxed differently. *See Indonesia—Autos* (Panel), paras. 14.121–14.122.

[77] *China—Auto Parts* (Appellate Body), para. 162; *China—Auto Parts* (Panel), para. 7.212 and the discussion in Chapter 7.

[78] *China—Auto Parts* (Appellate Body), paras. 161–3, 165; see also *India—Additional Import Duties* (Appellate Body), para. 153 with further references.

> Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III.

This text makes clear that 'border measures', defined as measures triggered because of the product's entering the market are *not* subject to the provisions of Article III, whereas internal taxes collected or enforced for administrative convenience at the point of importation (which used to be the custom house at the border)[79] do not change their character as internal measures as a consequence of the location of their collection. The determinant aspect is 'that the *obligation* to pay a charge must accrue due to an internal event, such as the distribution, sale, use or transportation of the imported product.'[80] A paradigmatic example would be a border tax adjustment.[81]

Direct taxes (in particular income taxes) do not fall a priori outside the scope of GATT Article III:2. GATT Article III:2 applies 'to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products'. This covers, of course, primarily taxes levied on products (for example, sales taxes, excise taxes, value-added taxes), which are often called indirect taxes, despite the fact that they are directly applied to each and any product.[82] However, income tax regulation has been a preferred and somewhat hidden way to discriminate against all things foreign, such as foreign income sources and foreign establishments.[83] Income tax (the prototypical 'direct tax') may *as such* not be covered by GATT Article III:2.[84] However, GATT Article III:2 covers, of course, income tax regulations to the extent that they directly affect the competitive position of foreign goods. An example would

[79] Internal taxes subject to Art. III:2 can be imposed at the border with respect to imports, this convenience permits 'border tax adjustment' (BTA) with respect to taxes on products or product components. With respect to imports, GATT Art. II:2(a) grants an exception to the rule limiting border charges to the amount of a scheduled tariff binding for 'a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III'. On the export side, a nation is allowed to refund the amount of any internal tax imposed on domestic goods. An interpretive note, *ad* Art. XVI:4, provides that such a rebate shall not be considered a subsidy or be the basis for countervailing or antidumping duties.

[80] *China—Auto Parts* (Appellate Body), paras. 139–41, 161–5. Under para. 162, the Appellate Body states: 'As already mentioned, in examining the scope of application of Article III:2, in relation to Article II:1(b), first sentence, the time at which a charge is collected or paid is not decisive. In the case of Article III:2, this is explicitly stated in the GATT 1994 itself, where the *Ad* Note to Article III specifies that when an internal charge is "collected or enforced in the case of the imported product at the time or point of importation", such a charge "is nevertheless to be regarded" as an internal charge. What is important, however, is that the *obligation* to pay a charge must accrue due to an internal event, such as the distribution, sale, use or transportation of the imported product.' *India—Additional Import Duties* (Appellate Body), para. 153, fn. 304 makes clear that '[w]hether a measure is a "charge" to which Article II:2(a) applies, or an "internal tax or other internal charge" referred to in the *Ad* Note to Article III, has to be decided in the light of the characteristics of the measure and the circumstances of the case.'

[81] cf. the GATT Working Party Report, *Border Tax Adjustments*, L/3464, adopted 2 December 1970, B.I.S.D. 18S/97, especially para. 14 (hereinafter: *Border Tax Adjustments*).

[82] *Mexico—Taxes on Soft Drinks* (Panel), para. 8.45; see also GATT Panel report, *Japan—Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, L/6216, adopted 10 November 1987, B.I.S.D. 34S/83, para. 5.8.

[83] See, for example, Case C-155/09, *Commission v Hellenic Republic* [2011] ECR I-65.

[84] See *Border Tax Adjustments*, n. 81.

be the non-deductibility of certain expenses for foreign (imported) products, in contrast with the deductibility of the costs for domestically produced goods:[85] If a logistics provider may deduct the costs for the domestically produced truck from her taxable income, but cannot do the same where she buys an imported lorry, the pertinent tax regulation would very much be a

> measure that indirectly affects the conditions of competition between imported and like domestic products would come within the provisions of Article III:2, first sentence, or by implication, second sentence, given the broader application of the latter.[86]

With the same rationale, tax *administration* measures are captured (possibly not exclusively)[87] by Article III:2;[88] customs fees incurred as a consequence of assessing duties, inspections, and validation of documents are subject to the discipline of GATT Article VII, and are therefore outside the scope of GATT Article III.[89] Fees and charges imposed by governments on currency exchange transactions (even in connection with the foreign exchange required to import goods) fall outside the scope of GATT Article III:2 but are addressed by GATT Article XV:4, pursuant to which exchange requirements must not 'frustrate the intent of the provisions of this Agreement'.

However, not all unilaterally imposed government levies and charges are taxes for the purpose of Article III:2, not the least because Article III:4 stands ready to capture any discriminatory state action involving the obligation to pay (more) than the domestic competitor: for instance, financial penalty provisions to enforce or incentivize behaviour have been held not to be 'taxes' (or charges pursuant to Article III:2) but measures captured pursuant to GATT Article III:4.[90] The same was held with regard to security deposits used to sanction local content obligations.[91]

3.2 Article III:2, sentence 1: national treatment of like products with regard to taxes

According to the Appellate Body in *Japan—Alcoholic Beverages II*:

> [T]he words of the first sentence [of Article III:2] require an examination of the conformity of an internal tax measure with Article III by determining, first, whether the taxed imported and domestic products are "*like*" and, second, whether the taxes applied to the imported products are "in excess of" those applied to the like domestic products.[92]

[85] See generally John H. Jackson, 'National Treatment Obligations and Non-Tariff Barriers' (1989) *Michigan Journal of International Law* 10, 207, 216–17.

[86] *Canada—Periodicals* (Appellate Body), 19.

[87] See earlier; certain tax administration measures may be subject to both Art. III:2 and III:4.

[88] *Thailand—Cigarettes* (*Philippines*) (Appellate Body), para. 114 with references; *Argentina—Hides and Leather* (Panel), para. 11.144.

[89] GATT Art. VII limits such charges to the approximate cost of services rendered.

[90] *US—Tobacco* (Panel), para. 80.

[91] Which are themselves incompatible with GATT Art. III:4; cf. GATT 1947 Panel *EEC—Animal Feed Protein*, para. 4.4.

[92] *Japan—Alcoholic Beverages II* (Appellate Body), 18–19.

Hence, two conditions have to be met in order for GATT Article III:2, sentence 1 to apply: (1) The imported and domestic products are *like products*; and (2) the imported products are taxed *in excess of* the domestic products.[93]

3.2.1 First element: the imported and domestic products are 'like products'

A key threshold for the right to NT is the likeness of the domestic and imported products at hand: Is a luxury SUV 'like' a subcompact car, or a motorbike? Is a workstation 'like' a game console? Is a *Nespresso* capsule 'like' roast and ground coffee? Is Japanese shochu like Russian or Swedish vodka?[94] After more than twenty years, the Appellate Body has still not produced a textbook definition, or, in its own word, a 'precise and absolute definition of what is "like"'.[95] Whereas some might see this as a shortcoming, the Appellate Body has rejected any such effort as futile, as 'there can be no . . . [such] definition'.[96] Rather, the

> concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the *WTO Agreement* are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.[97]

With these cautionary remarks in mind—that, of course, leave a very significant degree of interpretative power with the Appellate Body—we turn to case law that has defined the outer parameters of the *accordion of likeness*. It is important to recall, and not just for the new student of WTO law, that the very purpose of defining likeness is to find the aspects and circumstances that establish the existence, degree, and extent of the competitive relationship between the imported good at issue and *the*[98] like domestic good. This analytical process relies on criteria also used for the determination of the relevant market.[99] Because Article III does not define the right amount of taxation, but only defines an obligation to treat competing products in a non-protectionist and non-discriminating fashion, this first element of analysis is crucial. At some level, all products may be said to be at least indirectly competitive, given that end-consumers have limited disposable income for competing needs.[100] 'Likeness' and the broader

[93] The requirement to meet the *two-tier test* was confirmed by the Appellate Body in the following cases: *Canada—Periodicals*; *Chile—Alcoholic Beverages*; *EC—Asbestos; Japan—Alcoholic Beverages II; Korea—Alcoholic Beverages*; and *Thailand—Cigarettes.*

[94] It depends: Pursuant to *Japan—Alcoholic Beverages II* (Panel), para. 6.23, the answer is affirmative; this contrasts with the opposite view (with regard to Korean soju) in *Korea—Alcoholic Beverages* (Panel), para. 10.104. For further drink-related likeness evaluations see *Philippines—Distilled Spirits* (Appellate Body), para. 172 and *Mexico—Taxes of Soft Drinks* (Panel), para. 8.136.

[95] *Japan—Alcoholic Beverages II* (Appellate Body) 21.

[96] Ibid. [97] Ibid.

[98] Note that the treaty language always reads '*the* like product', rather than 'like products' or '*a* like product'.

[99] *Philippines—Distilled Spirits* (Appellate Body), paras. 215 (discussion of substitutability) and 221 (discussion on the extent to which groups of products have to be considered).

[100] *Philippines—Distilled Spirits* (Panel), para. 7.104, quoted approvingly by *Philippines—Distilled Spirits* (Appellate Body), paras. 204–5.

category of 'directly competitive or substitutable product' capture (and regulate) situations where the imported and domestic products compete directly.[101] And it is only for these two constellations that the NT obligation applies.

Already in 1970, the Working Party on *Border Tax Adjustments* had identified three criteria for determining, on a case-by-case basis, whether a product is 'similar':

(1) the product's end-uses in a given market (which may be very different from the use in another market; for example cognac in France may be a drink taken before or after meals; in Hong Kong it is also used to accompany meals);
(2) consumer tastes and habits in a given market (which may be very different from tastes and habits in another market; for example, in a country new to wine consumption—think of New Zealand sixty years ago—consumers may differentiate wine only by colour (red/white). In today's New Zealand, a South Island Pinot Noir may not be viewed as perfect substitution[102] for an South Australian Syrah at all);
(3) the product's properties, nature, and quality[103] (which are somewhat the same in every market). Of course a tricky question may be how close one may look: a microscope that allows the scientific determination that some fibres show a more harmful structure than others has been accepted;[104] whether the genesis of a product reflected in the molecular or other structures (for example, DNA) matters, has yet to be authoritatively decided.

Drawing on pre-WTO GATT Panel[105] precedents,[106] the Appellate Body found that product categorizations or classification by states and (domestic) regulatory

[101] In *EC—Asbestos*, the Appellate Body (para. 99) found that the determination of 'likeness' pursuant to Art. III:4 is, in principle, 'a determination about the nature and extent of a competitive relationship between and among products'.

[102] *Philippines—Distilled Spirits* (Appellate Body), para. 215.

[103] *Border Tax Adjustments*, n. 81, para. 18.

[104] *EC—Asbestos* (Appellate Body), paras. 99–100.

[105] See, for example, GATT Panel report, *Japan—Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, L/6216, adopted 10 November 1987, B.I.S.D. 34S/83, para. 5.6.

[106] The term precedent is used in a non-technical way: In international law and in jurisdictions not belonging to the common law family, court decisions are as such only laying the dispute at hand to rest and are thus only binding upon the parties. However, the Appellate Body has clarified in *US—Stainless Steel (Mexico)* (Appellate Body) that prior adopted reports of the Appellate Body (not of GATT Panels) have (very much like court-of-last-instance decisions in civil law jurisdictions) a very high degree of authority (paras. 158–62): 'It is well settled that Appellate Body reports are not binding, except with respect to resolving the particular dispute between the parties. This, however, does not mean that subsequent panels are free to disregard the legal interpretations and the *ratio decidendi* contained in previous Appellate Body reports that have been adopted by the DSB. Dispute settlement practice demonstrates that WTO Members attach significance to reasoning provided in previous panel and Appellate Body reports. Adopted panel and Appellate Body reports are often cited by parties in support of legal arguments in dispute settlement proceedings, and are relied upon by panels and the Appellate Body in subsequent disputes. In addition, when enacting or modifying laws and national regulations pertaining to international trade matters, WTO Members take into account the legal interpretation of the covered agreements developed in adopted panel and Appellate Body reports. Thus, the legal interpretation embodied in adopted panel and Appellate Body reports becomes part and parcel of the acquis of the WTO dispute settlement system. Ensuring "security and predictability" in the dispute settlement system implies that, absent cogent reasons, an adjudicatory body will resolve the same legal question in the same way in a subsequent case. In the hierarchical structure contemplated in the DSU, panels and the Appellate Body have distinct roles to play . . . [T]he Panel's decision to depart from well-established Appellate Body jurisprudence clarifying the interpretation of the same legal issues . . . has serious implications for the proper functioning of the WTO dispute settlement system.'

regimes,[107] *may* also assist a Panel in evaluating whether products are 'like', thus adding

(4) the customs classification of the product[108] and/or the internal regulatory regime of the product.[109]

In a recent report, the Appellate Body stated that whereas the determination of 'likeness' may *start* with analysing the physical characteristics of the products, none of the four criteria had a superior ('overarching') role for the purposes of 'likeness' determination. Rather, the Panel had to examine 'these criteria in order to make a determination about the nature and extent of a competitive relationship between and among the products'.[110]

Thus, the determination of likeness is an exercise that must, as a matter of principle, look at all available facts and circumstances that make the goods in question *alike*. As a consequence, the four criteria restated above (the *Border Tax Adjustment* criteria) are only tools to structure available evidence, as the Appellate Body acknowledges.[111] In particular, they *(a)* do not constitute a closed list,[112] *(b)* are indicative only, and *(c)* have to be weighed on a case-by-case basis.[113] The Appellate Body has underlined their function as tools to assist in the task of sorting, examining, and evaluating the relevant evidence:[114] While distinct, these criteria are therefore not mutually exclusive.[115] Thus, certain aspects of the factual relationship between products may well be assessed under several of the criteria presented above.[116] Clearly, this process seems less like exact

[107] See *Philippines—Taxes on Distilled Spirits* (Appellate Body), paras. 204–5.

[108] *Japan—Alcoholic Beverages II* (Appellate Body), 22, DSR 1996:I, 97 at 115–16: 'Uniform classification in tariff nomenclatures based on the Harmonized System (the "HS") was recognized in GATT 1947 practice as providing a useful basis for confirming "likeness" in products. However, there is a major difference between tariff classification nomenclature and tariff bindings or concessions made by Members of the WTO under Article II of the GATT 1994. There are risks in using tariff bindings that are too broad as a measure of product "likeness"... [T]here are numerous tariff bindings which are in fact extremely precise with regard to product description and which, therefore, can provide significant guidance as to the identification of "like products". Clearly enough, these determinations need to be made on a case-by-case basis. However, tariff bindings that include a wide range of products are not a reliable criterion for determining or confirming product "likeness" under Article III:2 [original fn. 50:] We believe, therefore, that statements relating to any relationship between tariff bindings and "likeness" must be made cautiously. For example, the Panel stated in paragraph 6.21 of the Panel Report that "... with respect to two products subject to the same tariff binding and therefore to the same maximum border tax, there is no justification, outside of those mentioned in GATT rules, to tax them in a differentiated way through internal taxation". This is incorrect.' See also *Philippines—Distilled Spirits* (Appellate Body), para. 161.

[109] See *Philippines—Distilled Spirits* (Appellate Body), paras. 166, 169.

[110] *Philippines—Distilled Spirits* (Appellate Body), para. 119, referring to the *EC—Asbestos* (Appellate Body) statement in para. 99, that 'a determination of "likeness" under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products'.

[111] Ibid. para. 131 (cf. also paras. 119 and 148).

[112] *Japan—Alcoholic Beverages II* (Appellate Body), DSR 1996:I, 97 at 113, 114. The Panel in *Dominican Republic—Import and Sale of Cigarettes*, paras. 7.333–7.336 viewed price as one such additional criterion; cf. also *Philippines—Distilled Spirits* (Panel), para. 7.59.

[113] *Japan—Alcoholic Beverages II* (Appellate Body), DSR 1996:I, 97 at 114.

[114] *EC—Asbestos* (Appellate Body), paras. 101 and 103; *Philippines—Distilled Spirits* (Appellate Body), para. 131. A particular framework to aid in the examination of evidence does not dissolve the duty or the need to examine, in each case, all of the pertinent evidence.

[115] *Philippines—Distilled Spirits* (Appellate Body), para. 131, citing *EC—Asbestos* (Appellate Body), para. 111.

[116] In *EC—Asbestos*, the Appellate Body considered health risks under both 'physical characteristics' and under 'consumers' tastes and habits', Appellate Body report, paras. 114, 120.

science and more like art, unavoidably not free from discretionary elements.[117] To be fair, the Appellate Body has provided Panels and the members with a number of quite important additional parameters guiding the holistic determination of whether the products in question are 'like'.

- The term 'like' in Article III:2, sentence 1, should be interpreted more narrowly than the very same term in Article III:4.[118] The reason for this (at first glance possibly counter-intuitive) non-homogenous interpretation is the context in which the two terms are used in the different paragraphs: In Article III:2, sentence 1, the term 'like product' finds itself back-to-back with 'directly competitive or substitutable products', used in the following sentence (Article III:2, sentence 2).[119] For those 'directly competitive or substitutable products', Article III:2, sentence 2, lays down a more permissive rule that differs from the rule in sentence 1. On the basis of the efficiency principle, pursuant to which every part of a treaty has to be interpreted in a way that gives meaning to it (rather than making it redundant or superfluous), 'like product' in Article III:2, sentence 1, is to be interpreted narrowly. In *Korea—Alcoholic Beverages*, the Appellate Body stated that 'like products' were a subset of 'directly competitive or substitutable products': 'perfectly substitutable products' were to fall under Article III:2, sentence 1, while 'imperfectly substitutable products can be assessed' pursuant to Article III:2, sentence 2.[120] It is not without irony that those perfectly substitutable products may be purely hypothetical, in order not to allow for the rewarding of past GATT-incompatible behaviour.[121]
- Despite the 'narrower' interpretation of GATT Article III:2, sentence 1, its catchment area is not reduced to products that are identical. In *Philippines—Distilled Spirits*, the Appellate Body stated that:

> products that have very similar physical characteristics may not be 'like', within the meaning of Article III:2, if their competitiveness or substitutability is low, while products that present certain physical differences may still be considered 'like' if

[117] *Japan—Alcoholic Beverages II* (Appellate Body), 20–1: 'In applying the criteria cited in *Border Tax Adjustments* to the facts of any particular case, and in considering other criteria that may also be relevant in certain cases, panels can only apply their best judgement in determining whether in fact products are "like".' However, the Appellate Body emphasized: 'This will always involve an unavoidable element of individual, discretionary judgement. We do not agree with the Panel's observation in paragraph 6.22 of the Panel Report that distinguishing between "like products" and "directly competitive or substitutable products" under Article III:2 is "*an arbitrary decision*". Rather, we think it is a discretionary decision that must be made in considering the various characteristics of products in individual cases' (emphasis added). Note that in *Japan—Alcoholic Beverages II*, shochu and vodka were considered 'like' whereas in *Korea—Alcoholic Beverages* they were considered as being not *like* but rather *directly competitive and substitutable goods.*

[118] *Japan—Alcoholic Beverages II* (Appellate Body), DSR 1996:I, 97 at 114 ('[T]he accordion of likeness is supposed to be narrowly squeezed'); *Canada—Periodicals* (Appellate Body), para. 466.

[119] *EC—Asbestos* (Appellate Body), paras. 94–5.

[120] *Korea—Alcoholic Beverages* (Appellate Body), para. 118. See also *Canada—Periodicals* (Appellate Body), para. 473; *Philippines—Distilled Spirits* (Appellate Body), para. 149.

[121] *Canada—Periodicals* (Appellate Body), 466 (as Art. III:2, sentence 1 'normally requires a comparison between imported products and like domestic products, and as there were no imports of [the product at hand] . . . hypothetical imports . . . have to be considered.')

such physical differences have a limited impact on the competitive relationship between and among the products. . . .

[W]e do not consider, . . . that the Panel committed an error of interpretation when it found that "likeness under the first sentence of Article III:2 is not limited to products that are identical". This statement by the Panel . . . is consistent with the notion that, while physical characteristics are one of the relevant criteria in the determination of "likeness" under Article III:2, even products that present certain differences may still be considered "like" if the nature and extent of their competitive relationship justifies such a determination.[122]

- Price may also be a criterion to determine likeness: if prices of given products are vastly different, this may be indicative of a non-competitive relationship.[123]
- In order to sanction state measures that differentiate between the treatment of goods *solely* on the basis of national origin, the Appellate Body and some Panels have dispensed with the usually required likeness analysis:

[W]here a WTO Member imposes an origin-based distinction with respect to internal taxes, imported and domestic products may be considered as like products, and a case-by-case determination of "likeness" between the foreign and domestic would be unnecessary.[124]

3.2.2 Second element: the imported products are taxed 'in excess of' the domestic products

If the imported and domestic products are 'like products', and if the taxes applied to the imported products are 'in excess of' those applied to the like domestic products, then the measure is inconsistent with Article III:2, sentence 1. Therefore, 'even the smallest amount of "*excess*" is too much.'[125] In particular, a member cannot offset ('balance') excessive taxes against above-standard treatment in other cases.[126] This prohibition of excessive taxes in Article III:2, first sentence, is not conditional on a 'trade effects test'[127] nor is it qualified by a *de minimis* standard. To the contrary, it suffices that an identical tax is subject to differentiated and less favourable application to arrive at a violation of the NT obligation.[128] Thus, the slightest margin of excessive taxing will constitute an infringement, even if the margin is *de minimis*.[129]

[122] *Philippines—Distilled Spirits* (Appellate Body), paras. 120–1.

[123] *Dominican Republic—Import and Sales of Cigarettes* (Panel), para. 7.333 and *Philippines—Distilled Spirits* (Panel), para. 7.59; in *Thailand—Cigarettes*, the Panel limited its analysis of likeness to cigarettes within the same price band, see para. 7.428.

[124] *Columbia—Port of Entry* (Panel), para. 7.182; see also *Indonesia—Autos* (Panel), para. 11.113.

[125] *Japan—Alcoholic Beverages II* (Appellate Body), 18–19; in *Argentina—Hides and Leathers* (Panel), para. 11.182, the Panel emphasized that GATT Art. III:2, sentence 1, was concerned with the economic impact of taxes and charges, and not the rate.

[126] *Argentina—Hides and Leathers* (Panel), para. 11.260.

[127] Ibid. paras. 11.182–11.183.

[128] In *Thailand—Cigarettes*, resellers of foreign cigarettes did not benefit from an automatic offset for VAT liabilities that applied to the resale of domestic cigarettes. The Appellate Body (*Thailand—Cigarettes* (Appellate Body), para. 116) approved the Panel's view 'that Thailand subjects imported cigarettes to internal taxes in excess of those applied to domestic cigarettes, within the meaning of Article III:2 first sentence.'

[129] *Japan—Alcoholic Beverages II* (Appellate Body), 23.

3.3 Article III:2, sentence 2: national treatment of directly competitive and substitutable products with regard to taxes

Article III:2, sentence 2 (together with the authoritative *Ad* note) reads (emphasis added):

> Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.
>
> [*Ad* Article III, paragraph 2]: A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a *directly competitive or substitutable product which was not similarly taxed.*

Article III:2, sentence 2, addresses the scenario that a domestic product is treated more favourably than an imported product; however, the imported product is not sufficiently similar to meet the narrow definition of 'like product' pursuant to Article II:2 sentence 1. However, such differential treatment may still be WTO-incompatible, provided the privileged product is 'directly competitive or substitutable' with the less well-treated foreign good. Accordingly, complaining members (being unable to predict whether the Panel will follow their assertion of 'likeness') should always also base their claim on Article III:2, sentence 2: if the Panel does not find a violation of Article III:2, sentence 1, it must still consider whether an infringement of Article III:2, sentence 2 has occurred.[130]

In *Japan—Alcoholic Beverages II*, the Appellate Body developed the *three-tier* test to be used under Article III:2, sentence 2, according to which three separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, sentence 2 (see the remainder of this section).[131] As stated in the context of GATT Article III:2, sentence 1, the purpose of these criteria is to determine the type and intensity of the competitive relationship between the products in question.[132] Thus, 'the determination of the appropriate range of "directly competitive or substitutable products" [as with 'like products'] . . . must be made on a case-by-case basis.'[133]

3.3.1 *The imported and domestic products are 'directly competitive or substitutable'*

Whereas the term 'competitive or directly substitutable products' has not received an authoritative interpretation by the drafters of the GATT or the Marrakesh Agreements

[130] *Canada—Periodicals* (Appellate Body), 470.

[131] *Japan—Alcoholic Beverages II* (Appellate Body), 26.

[132] *Canada—Periodicals* (Appellate Body), 19: 'Any measure that indirectly affects the conditions of competition between imported and like domestic products would come within the provisions of Article III:2, first sentence, or by implication, second sentence, given the broader application of the latter.' See also *Korea—Alcoholic Beverages* (Appellate Body), paras. 114–15, where it is emphasized that the competitive relationship between products may not be analysed exclusively by reference to current consumer preferences.

[133] *Japan—Alcoholic Beverages II* (Appellate Body), 25.

(the latter drawing on some forty years of application), it is well established through case law that it is a broader concept than 'likeness', used in sentence 1.[134] 'Directly competitive or substitutable products' include products that are *imperfectly* substitutable[135] and offer an 'alternative way of satisfying a particular need or taste'.[136] For instance, pursuant to case law, shochu is not like but directly competitive with 'whisky, brandy, gin, genever, rum and liqueurs'.[137]

Whether a product is indeed 'directly competitive or substitutable', is determined by applying the *Border Tax Adjustment* criteria, and as many additional factual aspects as the adjudicator deems appropriate in light of the facts of the case.

Emphasizing the nature of the GATT as a commercial agreement, the Appellate Body concluded that it did 'not seem inappropriate' to consider the competitive conditions in the relevant market, nor did it seem inappropriate to examine elasticity of substitution as one means of examining the relevant markets.[138] As competition is a 'dynamic, evolving process',[139] the concept of 'directly competitive or substitutable', 'is *not* to be analysed *exclusively* by reference to *current* consumer preferences',[140] but has to take into account what customers would prefer, had they not been impeded by state measures to get acquainted to the full range of choices available.[141] In *Philippines—Distilled Spirits*, the Appellate Body opined (obiter) that completely different prices could indicate separate markets, that is, a lack of competitive relationship between the products in question.[142] In this context, the Appellate Body explained in *Korea—Alcoholic Beverages* that whereas—in principle—the 'directly competitive or substitutable' relationship is determined by the conditions in the market at issue, it may be warranted to look at comparable *other* markets which were not exposed to similar protectionist measures:

> [C]onsumer responsiveness to products may vary from country to country. This does not, however, preclude consideration of consumer behaviour in a country other than the one at issue. It seems to us that evidence from other markets may be pertinent to the examination of the market at issue, particularly when demand on that market has been influenced by regulatory barriers to trade or to competition. . . . [I]f another market displays characteristics similar to the market at issue, then evidence of consumer demand in that other market may have some relevance to the market at issue.[143]

[134] *Korea—Alcoholic Beverages* (Appellate Body), para. 118 (the term 'like products' should be considered as a subset of 'competitive or substitutable product').

[135] *Canada—Periodicals* (Appellate Body), 19.

[136] *Korea—Alcoholic Beverages* (Appellate Body), para. 115.

[137] *Japan—Alcoholic Beverages II* (Panel), para. 6.32; see also *Canada—Perdiodicals* (Appellate Body), 19, 25, 28, where the Appellate Body emphasized that the second sentence was 'broader'.

[138] *Japan—Alcoholic Beverages II* (Appellate Body), 25.

[139] *Korea—Alcoholic Beverages* (Appellate Body), paras. 114–15.

[140] Ibid.

[141] *Philippines—Distilled Spirits* (Appellate Body), para. 226 ('[Instances] of current substitution are likely to underestimate latent demand for imported spirits as a result of distortive effects [of the measure at hand]').

[142] *Philippines—Distilled Spirits* (Appellate Body), para. 215.

[143] *Korea—Alcoholic Beverages* (Appellate Body), para. 137; see also ibid. para. 119.

Thus, if a product has a significant degree of substitutability without being identical it will normally fall into the category of *directly competitive or substitutable product*.[144]

3.3.2 *The domestic and imported products are 'not similarly taxed'*

Whereas even the slightest difference in tax between imported and domestic products will lead to an inconsistency with the criterion of 'in excess' in Article III:2, sentence 1, the following Article III:2, sentence 2 requires a somewhat less stringent degree of non-differentiation, commensurate with reduced competitive proximity of the goods in question. Members' obligation, pursuant to Article III:2, sentence 2, is limited to 'similarly tax' the competing products.[145] From this perspective, differentiation in tax treatment will only not be 'similarly taxed', if the differentiation is too small to actually have an effect on the competitive relationship (*de minimis*).[146] *Whether* a differential taxation is *de minimis* or not must be determined on a case-by-case basis, considering the particular circumstances of the constellation at hand.

3.3.3 *The dissimilar taxation is applied 'so as to afford protection' to domestic production*

Once it is established that directly competitive or substitutable imported goods are 'not similarly taxed', it must be established that this was done 'so as to afford protection to domestic production'. The Appellate Body rightly derives this criterion from the last part of Article III:2, sentence 2: the wording of the provision specifies that the two first criteria are only pertinent if the differential treatment is made effective 'in a manner contrary to the principles set forth in paragraph 1.' Paragraph 1, in turn, orders members not to differentiate between domestic and imported goods 'so as to afford protection to domestic production'.

While the criterion 'so as to afford protection' need not be established independently in a finding of a violation with Article III:2, sentence 1 (due to the lack of any reference to paragraph 1), it must be established pursuant to GATT Article III:2, sentence 2 as a consequence of that specific linkage to paragraph 1.[147] This

> third inquiry under Article III:2, second sentence, must determine whether "directly competitive or substitutable products" are "not similarly taxed" in a way that affords protection. This is not an issue of intent. It is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent.... It is irrelevant that protectionism was not an intended objective if the particular tax measure in question is nevertheless, to echo Article III:1, "*applied* to imported or

[144] *Philippines—Distilled Spirits* (Appellate Body), para. 198.

[145] *Japan—Alcoholic Beverages II* (Appellate Body), 27; see also *Canada—Periodicals* (Appellate Body), 28–9; *Chile—Alcoholic Beverages* (Appellate Body), para. 49.

[146] *Canada—Periodicals* (Appellate Body), 28–9: the complained-against tax was 'sufficient to prevent the production and sale' of the product in question.

[147] *Japan—Alcoholic Beverages II* (Appellate Body), 19–23.

> domestic products so as to afford protection to domestic production." This is an issue of how the measure in question is *applied*. . . .
>
> Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application, as the Panel rightly concluded in this case. Most often, there will be other factors to be considered as well. In conducting this inquiry, panels should give full consideration to all the relevant facts and all the relevant circumstances in any given case.[148]

Whether the design, architecture, structure, and overall application of the measure do reveal a protective nature of the measure in question can only be determined 'on a case by case basis, taking account of all relevant facts.'[149] Of course, in difficult factual circumstances a Panel will have to make a judgement call as to whether this is the case, and reasonable people may disagree with a decision that is characterized by a significant margin of appreciation. In *Chile—Alcoholic Beverages*, the Appellate Body viewed Chile's tax system as being incompatible with its obligations under the GATT, despite the fact that the majority of the goods falling into a less favourable tax category were of domestic origin. However, what made the system (in the eyes of the Appellate Body) 'objectively' protectionist was the fact that almost all imported products fell into the less favourable category, whereas 75 per cent of the domestic production benefited from a much more advantageous treatment. Article III:2, sentence 2 provides for

> equality of competitive conditions of *all* directly competitive and substitutable imported products in relation to domestic products, and not simply . . . these imported products within a particular fiscal category.[150]

Thus, the closer a competitive relationship is to perfect substitutability, the more Article III:2 limits state interference in favour of the domestic like product to avoid undesired protectionist consequence. Article III:2, sentence 1 allows no leeway at all, whereas Article III:2, sentence 2 (which applies to less perfect substitutable goods) permits more regulatory space. For the remainder of all products, which are also in some form of competitive relationship (due to the fact that a given sum of money can only buy a limited number of goods), Article III imposes no discipline.

4. Article III:4—Internal Laws and Regulations

The national treatment obligation in GATT 1994 Article III:4[151] prohibits discrimination through measures affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of the imported product.[152] According to WTO

[148] *Japan—Alcoholic Beverages II* (Appellate Body), 27–9 (emphasis in the original).
[149] *Korea—Alcoholic Beverages* (Appellate Body), para. 137.
[150] *Chile—Alcoholic Beverages* (Appellate Body), para. 67 (emphasis in the original).
[151] Art. III:5 and Art. III:7 prohibit the use of mixing requirements or internal quantitative requirements (such as local content conditions) that favour domestic products.
[152] *China—Auto Parts* (Appellate Body), paras. 187–9; *Brazil—Tyres* (Panel), paras. 7.414–7.416.

jurisprudence, a state measure is inconsistent with the obligation laid down in GATT Article III:4, if each of the following three questions is answered in the affirmative:

- Are the imported and domestic products concerned *like products*?
- Is the measure in question a *law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use*?
- Are the imported products *afforded less favourable treatment than like domestic products*?

The tone for the application of Article III:4 was set by a 1958 GATT Panel that considered a complaint by the United Kingdom against Italy. The latter had provided loans at preferential rates to Italian farmers to facilitate the purchase of Italian-made tractors. In *Italian Discrimination Against Imported Agricultural Machinery*,[153] a GATT Panel interpreted Article III:4 'to provide equal conditions of competition once goods had been cleared through customs'.[154] Furthermore, Article III:4 was held to cover 'not only the laws and regulations which directly governed the conditions of sale or purchase but also laws or regulations which might adversely modify the conditions of competition between domestic and imported products'.[155] The Panel rejected the argument that economic development measures were permitted under this provision: 'such protection should be given in ways permissible under the General Agreement'.[156] Article III:8(b), which permits 'subsidies exclusively to domestic producers, including payments . . . derived from the proceeds of internal taxes', was declared not applicable because the credit subsidies were being extended to buyers, not producers.[157] Overall, the report established the precedent that Article III:4 was to be read broadly and to considerably limit the right of GATT contracting parties to use internal (non-tariff) measures for protectionist purposes. It is still good law today. Note that the Annex of the TRIMs Agreement, discussed later contains an illustrative list of measures that are incompatible with Article III:4 (and happen to be impediments to investors).[158]

4.1 The (allegedly) preferentially treated domestic product needs to be 'like'

In a similar fashion to what it does in the context of Article III:2, the Appellate Body uses a likeness analysis similar to the one applied for market definitions in competition

[153] *Italian Discrimination Against Imported Agricultural Machinery*, n. 2.
[154] Ibid. para. 13. [155] Ibid. para. 12. [156] Ibid. para. 16.
[157] Ibid. para. 9; see also GATT Panel report, *US—Malt Beverages*, para. 5.8 and *EC—Commercial Vessels* (Panel), where the Panel found that the EC's 'Temporary Defensive Mechanism', granting state aids to shipbuilding industries, was permitted under GATT Art. III:8(b) and *Canada—Periodicals* (Appellate Body), 32 *et seq*.
[158] '1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require: (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or (b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.

law, in order to determine the extent and degree of competitive relationships. Not surprisingly, the four *Border Tax Adjustment* criteria for determining 'likeness'[159] are again not more than indicative, certainly not a closed list, and more an organizational structure to facilitate 'the task of sorting and examining' the relevant evidence.[160]

However, the scope of 'likeness' in Article III:4 has been found by the Appellate Body to be somewhat wider than that in the first sentence of Article III:2.[161] This follows from the reading that Article III:2, sentence 1, must be understood in the context of the following sentence, where a special (less demanding) standard for 'directly competitive and substitutable' products is established.[162]

While the Appellate Body is clearly advocating a market-based economic approach—rejected, it should be mentioned, by the concurring opinion in *EC—Asbestos*[163]—it seems noteworthy that it was in the context of a 'likeness analysis' pursuant to Article III:4 that the Appellate Body underlined the importance of considering all relevant facts which include consumer perception of health risks and the effect of goods on health when used as recommended. The health dangers emanating from asbestos fibres were considered to be a good enough reason to view those fibres as 'un-like' other sorts of fibre-based insulating materials (such as stone wool).[164] Two particularly well-placed authors have recently pointed out that likeness is 'a matter of judgment—qualitatively as well as quantitatively'.[165]

Whereas GATT Article III:4 does not contain a specific reference to paragraph 1, it has still to be read in the light of the overall purpose of the NT provision, contained in Article III:1:

> [A]lthough this "general principle" is not explicitly invoked in Article III:4, nevertheless, it "informs" that provision. Therefore, the term "like product" in Article III:4 must be interpreted to give proper scope and meaning to this principle. In short, there must be consonance between the objective pursued by Article III, as enunciated in the "general principle" articulated in Article III:1, and the interpretation of the specific expression of this principle in the text of Article III:4. This interpretation must, therefore, reflect that, in endeavouring to ensure "equality of competitive conditions", the "general principle" in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, *between the domestic and imported products involved*, "so as to afford protection to domestic production".[166]

[159] *EC—Asbestos* (Appellate Body), paras. 101, 103: the Appellate Body confirmed the following criteria: (i) the product's end-uses; (ii) consumers' tastes and habits; (iii) the product's nature, properties, and quality; and (iv) the customs classification of the products. As mentioned earlier, these criteria are first and foremost tools to assist in the task of sorting and examining the relevant evidence.

[160] *EC—Asbestos* (Appellate Body), para. 102.

[161] Ibid. para. 95.

[162] *Japan—Alcoholic Beverages II* (Appellate Body), 97, 112.

[163] This, of course, has met opposition even in the Appellate Body, see the concurring statement of one member of the Division, *EC—Asbestos*, para. 154.

[164] *EC—Asbestos* (Appellate Body), para. 122.

[165] Van den Bossche and Zdouc, *The Law and Policy of the World Trade Organization* (2013), n. 66 at 388.

[166] *EC—Asbestos* (Appellate Body), para. 98.

However, while the scope of 'likeness' in Article III:4 exceeds, according to the Appellate Body, likeness pursuant to Article III:2, sentence 1, it is not broader than the combined product-scope of the *two sentences* of Article III:2.[167]

4.2 The measure is a law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of the products

Article III:4 relates to all laws, regulations, and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of products. In *Canada—Autos*, the Panel, in a finding subsequently implicitly endorsed by the Appellate Body, noted that the word '*affecting*' in GATT 1994 Article III:4 has been interpreted since the *Italian Machinery* case to cover not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products,[168] therefore covering a 'broad scope of application'.[169] *Canada—Autos* confirmed that a measure can be subject to Article III:4 even if compliance with it is not mandatory as it also applies to conditions that an enterprise accepts voluntarily in order to receive an advantage.[170] Of course, imposing 'additional administrative procedure' on the imported products to encourage the domestic manufacturers in using the domestic products is considered to '*affect*' the products concerned,[171] even if the primary purpose of the measure was not aimed at regulating the sale. In *Mexico—Taxes on Soft Drinks*, the Panel opined that measures falling under Article III:2 may at the same time, due to their effect on internal use, fall under Article III:4.[172] While this would seem not easily compatible with the efficiency principle normally emphasized by the Appellate Body, the latter endorsed this view in *China—Autoparts*.[173]

[167] Ibid. para. 94.

[168] *Canada—Autos* (Panel), paras. 10.80, 10.84–10.85; *India—Autos* (Panel), paras. 7.195–7.198, 7.304–7.307, 7.313–7.315. Other examples include regulations imposing the disposal of ten used tyres as a condition for importing one retreated tyre (*Brazil—Retreated Tyres* (Panel), para. 7.433); defining (only) one distribution channel for imported newspapers and periodicals (*China—Publications and Audiovisual Products* (Panel), para. 7.1513); imposing imported electronic sound recordings to content review regimes (*China—Publications and Audiovisual Products* (Panel), para. 7.1595); subjecting resellers of imported cigarettes to unfavourable administrative requirements related to VAT (*Thailand—Cigarettes (Philippines)* (Panel), para. 7.665); resulting in higher railway transportation costs for imported grain (*Canada—Wheat Exports and Grain Imports* (Panel), para. 6.331 *et seq.*); prohibiting storage of foreign origin in grain elevators containing domestic grain (*Canada—Wheat Exports and Grain Imports* (Panel), para. 6.262); requiring that imported cigarettes cannot leave the bonded warehouse unless the tax stamps are affixed to each packet in the presence of a tax inspector (*Dominican Republic—Import and Sale of Cigarettes* (Panel), paras. 7.170–7.171); requiring the purchase of rice from domestic producers in order to receive authorization to import rice at preferential tariff levels (*Turkey—Rice* (Panel), para. 7.219). From pre-WTO jurisprudence, see *Canada—Provincial Liquor Board (US)*, para 5.30); *US—Malt Beverages*, para. 5.32; *Thailand—Cigarettes*, para. 78; *Canada—FIRA*, para. 5.12 *et seq.*

[169] *US—FSC* (Appellate Body), paras. 208–10; see also *US—FSC (Article 21.5—EC)* (Appellate Body), para. 210 and *US—Section 337 Tariff Act* (Panel), para. 5.10.

[170] *Canada—Autos* (Panel), para. 10.73.

[171] *China—Auto Parts* (Appellate Body), paras. 194–5.

[172] *Mexico—Taxes on Soft Drinks* (Panel), para. 8.113.

[173] *China—Auto Parts* (Appellate Body), paras. 183, 197.

Purely private measures are not covered by Article III:4. However, pursuant to the general rules of public international law, as restated in Article 8 of the Draft Articles on State Responsibility, private conduct will be attributed to a state, 'if the person or group of persons is in fact acting on the instructions of, or under the direction or control of, that State in carrying out the conduct'. If this can be shown in the context of Article III, a complaint will be successful;[174] if, to the contrary, that special nexus cannot be demonstrated, the complaint will be rejected.[175]

4.3 The imported products 'are afforded less favourable treatment'

If a measure affords an imported product 'less favourable treatment' than the one provided for the like domestic product, the measure will be inconsistent with the national treatment obligation under Article III:4.[176] The 'no less favourable' treatment standard is violated if a measure diminishes the 'effective equality of opportunities for imported products'.[177] Balancing less favourable treatment for imports in some instances and more favourable treatment in others is not an option for complying with Article III:4.[178]

However, a 'formal difference in treatment between imported and like domestic products is . . . neither necessary nor sufficient to show a violation of Article III:4.'[179] Something more is required, given the anti-protectionist purpose of the whole NT provision.[180] Accordingly, the determination of whether or not imported products are treated 'less favourably' than like domestic products needs to be based on an examination of whether a measure *modifies the conditions of competition* in the relevant market to the detriment of imported products.[181]

[174] See, for example, *Turkey—Rice* (Panel), paras. 7.217–7.225; *India—Autos* (Panel), paras. 7.177–7.194; *Canada—Autos* (Panel), para. 10.107; *Canada—Periodicals* (Panel), para. 5.33 *et seq*. cf. also GATT Panel report, *Japan—Trade in Semi-Conductors*, L/6309, adopted 4 May 1988, B.I.S.D. 35S/116, paras. 106–9, where the GATT Panel interpreted the word 'measures' in GATT Art. XI to refer not only to laws and regulations but also to non-mandatory government involvement: It set out a two-part test for determining whether non-mandatory government requests could be regarded as 'measures' within the meaning of Art. XI. First, whether there were sufficient incentives for the requests to take effect and second, whether the operation of the measures was dependent on government action. Ibid. para. 109. The Panel determined that non-binding 'administrative guidance' by the Japanese government was within the scope of Art. XI. Ibid. paras. 117–18.

[175] *China—Publications and Audiovisual Products* (Panel), para. 7.1693 *et seq.; Korea—Various Measures on Beef* (Appellate Body), para. 149.

[176] *Thailand—Cigarettes* (Appellate Body), paras. 128–30, 133–4.

[177] *US—Section 337 Tariff Act* (Panel), para. 5.11.

[178] *US—Reformulated Gasoline* (Panel), para. 6.14; referring to *US—Section 337 Tariff Act* (Panel), para. 5.14.

[179] As stated earlier, the Appellate Body rejects a specific analysis of whether the state measure in question 'affords protection to domestic production' pursuant to para. 1 (*EC—Bananas* (Appellate Body), para. 216), which, however, 'informs' the whole of Art. III. Therefore, pursuant to GATT Art. III:4, internal regulations 'should not be applied . . . so as to afford protection to domestic production'; see *Korea—Various Measures on Beef* (Appellate Body), para. 137; see also *US—Section 337 Tariff Act* (Panel), para. 5.11.

[180] Without this being a separate criterion in the examination: *Japan—Alcoholic Beverages II* (Appellate Body), 111; *EC—Asbestos* (Appellate Body), paras. 93, 100; *Korea—Various Measures on Beef* (Appellate Body), para. 137.

[181] *Korea—Various Measures on Beef* (Appellate Body), para. 137; see also ibid. paras. 144, 149, 150, and 151; *Dominican Republic—Cigarettes* (Appellate Body), para. 96; *US—FSC (Article 21.5—EC)* (Appellate Body), para. 221.

Thus, in *Korea—Beef*, a 'dual retail system' for marketing beef that confined sales of imported beef to specialized stores was analysed with regard to that benchmark.[182] Korean law had created two distinct retail distribution systems for beef: one for domestic beef and another for imported beef only. Large shops were allowed to continue carrying both domestic and imported beef, provided they established physically separate sales areas. Retailers selling imported beef were required to display a sign reading 'Specialized Imported Beef Store'. While the formal separation was, in the Appellate Body's view, *as such* not a violation of the command to treat foreign products not less favourable pursuant to GATT Article III:4, it was of the opinion that the separate retail distribution system for domestic and imported products 'modified[d] the conditions of competition in the Korean beef market to the disadvantage of the imported product'.[183] Objectively, the effect had been the reduction of retail outlets for imported beef, both in absolute terms and compared with the number of retail outlets for home-grown beef. This 'reduction of competitive opportunity'—and not the volume of beef sold—led to the Appellate Body's finding that the measure was not consistent with the requirements of GATT Article III:4.[184] This line of reasoning has been confirmed in more recent Appellate Body reports.[185]

One of the more notorious constellations examined in the context of GATT Article III:4 are domestic measures prescribing (minimum) national local content and a certain relationship between imports and exports ('trade balancing requirements'). In the case of *India—Autos*,[186] the WTO Panel found that India's regulation requiring automotive manufacturers to sign a memorandum of understanding imposing an obligation to use a certain proportion of local parts and components in the manufacture of cars and vehicles was 'less favourable'. A condition requiring the balancing of imports with exports was similarly viewed as being incompatible with Article III:4. Such cases are now included in the Annex to the TRIMs Agreement mentioned earlier.

In *Dominican Republic—Import and Sale of Cigarettes*, the Appellate Body upheld the panel's finding that a stamp tax requirement, whereby tax stamps must be affixed to cigarette packets in the territory of the Dominican Republic under the supervision of Dominican tax officials, was inconsistent with Article III:4. The Panel had opined:

> although the tax stamp requirement is applied in a formally equal manner to domestic and imported cigarettes, it does modify the conditions of competition in the marketplace to the detriment of imports. The tax stamp requirement imposes additional processes and costs on imported products. It also leads to imported cigarettes being presented to final consumers in a less appealing manner.

[182] *Korea—Various Measures on Beef* (Appellate Body), para. 75(c).

[183] Ibid. para. 144.

[184] Ibid. paras. 147–8. (The Appellate Body did not rule on the question whether the display sign requirement was a separate Art. III violation. Ibid. para. 151.)

[185] *US—FSC (Article 21.5—EC)* (Appellate Body), para. 215; *Thailand—Cigarettes (Philippines)* (Appellate Body), para. 135.

[186] *India—Autos* (Panel).

On the other hand, the Appellate Body also upheld the Panel's finding that a bond requirement, requiring that both importers and domestic producers post a bond to ensure payment of taxes, was not inconsistent with Article III:4.

> [We do not accept] Honduras' argument that the bond requirement accords "less favourable treatment" to imported cigarettes because, as the sales of domestic cigarettes are greater than those of imported cigarettes on the Dominican Republic market, the per-unit cost of the bond requirement for imported cigarettes is higher than for domestic products. The Appellate Body indicated in *Korea—Various Measures on Beef* that imported products are treated less favourably than like products if a measure modifies the conditions of competition in the relevant market to the detriment of imported products. However, the *existence of a detrimental effect* on a given imported product resulting from a measure *does not necessarily imply* that this measure accords *less favourable treatment* to imports *if the detrimental effect is explained* by factors or circumstances unrelated to the foreign origin of the product, such as the market share of the importer in this case.[187] In this specific case, the mere demonstration that the per-unit cost of the bond requirement for imported cigarettes was higher than for some domestic cigarettes during a particular period is not, in our view, *sufficient* to establish "less favourable treatment" under Article III:4 of the GATT 1994. Indeed, the difference between the per-unit costs of the bond requirement alleged by Honduras is explained by the fact that the importer of Honduran cigarettes has a smaller market share than two domestic producers ... [T]he difference between the per-unit costs of the bond requirement alleged by Honduras does not depend on the foreign origin of the imported cigarettes.[188]

Two important aspects of this statement should be underlined. If the foreign origin is the reason of a differential treatment that leads to *some* detrimental impact, it will be very difficult indeed for such discriminatory measure to not be found in violation of Article III:4. If, however, the measure is even-handed, a de facto negative impact only will be found to be protectionist and hence in violation of Article III:4 (as *informed* by paragraph 1), if the detrimental effect is linked to the foreign origin. In the words of the Appellate Body's *Thailand—Cigarettes* report, there must be 'a genuine relationship between the measure at issue and its adverse impact on competitive opportunities for imported versus like domestic products.'[189] Thus, a complainant under Article III:4 must carry a relatively high burden of proof to show 'less favourable conditions of competition'.[190]

[187] Emphasis added.
[188] *Dominican Republic—Cigarettes* (Appellate Body), para. 96.
[189] *Thailand—Cigarettes* (Appellate Body), para. 134.
[190] *Japan—Film* is an example of an unsuccessful attempt to show infringement of Art. III:4. In that case, the US argued that twenty-three different Japanese government measures had the combined effect of granting less favourable treatment to imported films and nullified and impaired benefits US producers should have obtained from previous tariff negotiating rounds. However, in the Panel's view the US had not sufficiently demonstrated the claims of non-violation; see *Japan—Film* (Panel), paras. 6.79–6.81.

5. Application of Article III to State-trading Monopolies

GATT Article III applies to state-trading monopolies as there is no exemption for such monopolies to be found in Article III, Article XVII, or anywhere else in the GATT. As illustrated by a 1992 pre-WTO case, *Canada—Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*,[191] a state-trading company violates Article III:4 if it treats imports less favourably than competing domestic products:

> [N]othing in the [GATT] . . . prevented Canada from establishing import and sales monopolies that also had the sole right of internal delivery. The only issue before the Panel was whether Canada, having decided to establish a monopoly for the internal delivery of beer, might exempt domestic beer from that monopoly. The Panel noted that Article III:4 did not differentiate between measures affecting the internal transportation of imported products that were imposed by governmental monopolies and those that were imposed in the form of regulations governing private trade. . . . The Panel recognized that a beer import monopoly that also enjoyed a sales monopoly might, in order properly to carry out its functions, also deliver beer, but it did not for that purpose have to prohibit unconditionally the private delivery of imported beer while permitting that of domestic beer.[192]

In the same report, the Panel also addressed Article III:2:

> The Panel considered that this provision [Article III:2, first sentence] applied not only to the provincial and federal sales taxes but also to the mark-ups levied by the liquor boards because they also constituted internal governmental charges borne by products.[193]

6. Application of Article III National Treatment Obligations to Sub-National Units of WTO Members

GATT Article III, like all obligations derived from the WTO Agreement, also applies to regulatory restrictions and taxes imposed by sub-federal governmental entities such as Canadian provinces, Swiss cantons, or US states; this follows from Article XVI:4 of the WTO Agreement.[194] In that case, it is not a valid justification, if the restrictions imposed on imported products are also imposed on products from other constituent units of the confederation.[195] Thus, GATT Article III must be observed by all local and regional governmental entities of WTO members,[196] regardless of the degree of autonomy they enjoy under the respective constitutional arrangement.

[191] GATT Panel report, *Canada—Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, DS17/R, adopted 18 February 1992, B.I.S.D. 39S/27, para. 5.15, (hereinafter: *Canada—Provincial Liquor Boards (US)*).

[192] Ibid. para. 5.15.

[193] Ibid. para. 5.24.

[194] If an integral part of a member enjoys 'full autonomy in the conduct of its external commercial relations' (for example, Hong Kong), Art. XII of the WTO Agreement applies.

[195] *US—Malt Beverages,* n. 38 at para. 5.1.

[196] cf. Art. XVI:4 of the WTO Agreement.

7. The Relationship between GATT Article III and Article XI

GATT Article III applies to internal taxation and regulation, whereas GATT Article XI applies to specific border (other than tariffs addressed in GATT Article II) measures such as quotas, import or export licences.[197] Accordingly, the two provisions normally cover different situations, and questions of demarcation do not arise.[198]

However, the distinction between Article XI and Article III may present difficulties, when importation *as such* is not prohibited, but rendered meaningless by a complete ban on the marketing and use of a product. The question then arises, whether the enforcement at the border of such a measure is a border measure, subject to Article XI or rather an internal measure. According to the *ad* Note to Article III, internal rules applying to imported and like domestic products (such as a complete ban of the product 'asbestos')[199] and enforced at the time of importation for the imported product remain internal and subject to Article III.

In *India—Autos* the Panel had to deal with a situation where the measure in question had to be analysed both pursuant to Article III and Article XI.[200] Ordinarily, a measure will often be analysed first under Article III.[201]

8. Exceptions to the National Treatment Principle

Like all GATT obligations, Article III is subject to

- the general exception, GATT Article XX;[202]
- the security exception, GATT Article XXI;
- the balance of payment exception and temporary application of quantitative restrictions in a discriminatory manner, GATT Articles XII, XVIII.B, and XIV;
- waivers (Article IX:3 of the Agreement Establishing the WTO).

[197] Or 'other measures . . . instituted or maintained . . . on the importation . . . or exportation . . . or any product', GATT Art. XI; cf. GATT Panel report, *Japan—Trade in Semi-Conductors*, L/6309, adopted 4 May 1988, B.I.S.D. 35S/116.

[198] See Robert Stelzer, 'GATT Doctrine and the Limits of the WTO: An Investigation into Germany's Stem Cell Act' (2008) *Journal of World Trade* 42, 865, 876 *et seq.*

[199] Example from Holger P. Hestermeyer, 'Art. III GATT' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011), para. 110.

[200] *India—Autos* (Panel), paras. 7.221, 7.224, 7.296; see from pre-WTO times GATT Panel report, *Canada—Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, L/6304, adopted 22 March 1988, B.I.S.D. 35S/37, para. 4.26; Hestermeyer, 'Art. III GATT', n. 199 at para. 110 with further references.

[201] This was the Panel's analysis in the *Tuna–Dolphin* cases. See n. 58. The US embargo on tuna caught by dolphin-unsafe methods was analysed under Art. III in *US—Tuna (Mexico)*, paras. 5.9–5.15, and in *US—Tuna (EEC)*, paras. 5.8–5.9. After Art. III was found inapplicable because the US embargo concerned fishing techniques rather than the product itself, the embargo was judged inconsistent with Art. XI. According to Hestermeyer, 'Art. III GATT', n. 199 at para. 110, no specific order is necessary for analysing claims which rely on both Arts. XI and III. See on the interplay between Arts. III and XI, Erich Vranes, 'The WTO and Regulatory Freedom: WTO Disciplines on Market Access, Non-Discrimination and Domestic Regulation Relating to Trade in Goods and Services' (2009) *Journal of International Economic Law* 12, 953, 957 *et seq.*

[202] *EC—Asbestos* (Appellate Body), para. 115.

Moreover, specific exceptions related to the national treatment principle may, in a nutshell, be summarized as follows:

8.1 Government procurement (GATT Article III:8(a))

In the context of government agencies purchasing products for governmental purposes,[203] advantages or preferences may be accorded to domestic products over imported ones. In contrast, the (plurilateral) Agreement on Government Procurement obliges the contracting parties to largely undo those restrictions inter se, opening up the procurement process by government entities to international competition.[204]

8.2 Subsidies to domestic producers (GATT Article III:8(b))

Regardless of possible limitations pursuant to GATT Article III:1 and III:4, members may provide certain subsidies to domestic producers derived from the proceeds of internal taxes. Since the *Italian Agricultural Machinery* case, this exception has received a narrow interpretation.[205]

8.3 Internal maximum price control measures (GATT Article III:9)

Members recognize that (internal) maximum price control measures, even though conforming to GATT Article III:4 can have effects prejudicial to the interests of the members supplying imported products. Accordingly, members applying such measures shall take account of the interests of exporting members with a view to avoiding to the fullest practicable extent such prejudicial effects.

8.4 Cinematographic films (GATT Articles III:10 and IV)

As an exception to the national treatment principle, members retained the possibility of giving preferences to goods produced by the national film industry (exposed cinematographic films). National preferences are governed by the provisions of GATT Article IV, and may take the form of internal quantitative regulations ('screen quotas').[206]

[203] And not for commercial resale or use in the production of goods for commercial sale (Art. 1 of the Agreement on Government Procurement).

[204] See Chapter 18.

[205] cf. *US—Malt Beverages*, n. 38 at para. 5.8; *Canada—Periodicals* (Appellate Body), 32 *et seq*. and *EC—Commercial Vessels* (Panel), paras. 7.55–7.75.

[206] See also Art. III:10 and the specific commitments made by members in the audio-visual sector in the GATS; see Lothar Ehring, 'Art. IV GATT' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011).

8

Tariffs, Quotas, and Other Barriers to Market Access for Goods

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1. Introduction

Market access barriers come in different forms and shapes. A first category consists of 'border measures', that is, measures attributable to a state, which have the purpose of precluding, restricting, or channelling *access* to a given market. Prototypical measures include tariffs, customs regulations, import licensing, or quotas. The second category covers *internal regulations* and practices that have protective effects. This includes, inter alia, 'behind-the-border' regulations relating to products and services as well as their distribution and sale, subsidies, state-trading monopolies, government procurement policies, technical standards requirements, and health and safety measures; a central WTO obligation dealing with such domestic regulation has just been addressed in the preceding

chapter. A third category may be used to capture *private business practices and customs*, including restrictive business practices, as well as social and cultural differences affecting business behaviour, and, lastly, consumer preferences. Finally, economic and structural characteristics of the importing country, such as government credit and investment policies, industrial policies, and macroeconomic policies that, for example, induce saving and constrain consumption, that do *not* fall into the second group would merit a fourth category.

GATT and WTO rules do not attempt to reach all of the above categories of obstacles to trade. Rather, they limit themselves to regulating *state measures*, that is, measures attributable to members, which entail the responsibility of the state concerned. Thus, both border measures such as tariffs and quotas (category 1) and internal measures of all kinds (category 2) are the subject of black-letter WTO law. Some state measures falling into the fourth category may be subject to the non-violation or situation complaint procedures pursuant to DSU Article 26. Starting with the Tokyo Round Agreements in 1978, the state parties to the GATT started addressing somewhat less obvious trade impediments falling into both of the above categories such as import licensing, the regimes curtailing the effects of subsidies and dumping, and the role of standards ('technical barriers to trade').[1] In this chapter, we shall focus on the age-old classic market access barriers that prevent a product either from even crossing the border (quotas, including quotas that allow zero importation) or that render it less competitive by raising its price (tariffs, customs duties). Whereas many of the non-tariff barriers are discussed in this book in the chapters devoted to instruments that are not infrequently used for rendering market access more difficult (such as standards, anti-subsidies, and antidumping measures), we shall touch upon some other measures which have been tested in the dispute settlement mechanism. We shall start with the law on tariffs on goods, an area important enough to put the first 'T' into GATT.

2. Tariffs and Customs Rules

2.1 Introduction

The heart of GATT's market access law can be found in GATT Articles II, XXVIII, XXVIII*bis*, and XI.[2] Read together, these norms prohibit quantitative restrictions, in particular quotas, and establish tariffs as the market access restriction of choice: GATT Article II, far from prohibiting tariffs, provides the legal tool to render them more transparent and easy to negotiate by binding members vis-à-vis their fellow members to adhere to maximum tariff rates reflected in their respective schedules of concessions.[3] Accordingly, tariffs 'are GATT's border protection "of

[1] cf. Andreas F. Lowenfeld, *International Economic Law* (Oxford University Press, 2002), 54 *et seq*.

[2] See, also for the following, Michael Hahn, 'Trade in Goods: Article II GATT' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011).

[3] The Appellate Body characterizes tariffs as 'the preferred trade policy instrument, whereas quantitative restrictions are in principle prohibited': *India—Additional Import Duties* (Appellate Body), para. 159.

choice"'[4] and are supposed to substitute most, if not all, other border measures, in particular the outlawed (GATT Article XI) quantitative restrictions.

Because any restriction on the liberty to increase tariff rates is disadvantageous from a mercantilist perspective (as it restricts the defensive options to react against foreign commercial aggression), it will only be accepted if and to the extent that this concession has been 'paid for' through an overall equivalent corresponding benefit. The way to achieve this balance is negotiations. Once largely negotiated on a bilateral level—as is still visible in concepts such as *initial negotiation rights* (INRs, cf. GATT Article XXVIII)—and then multilateralized through the most favoured nation principle (MFN), 'general' tariff negotiations seem somewhat blocked since 1995.[5]

The Ministerial Declaration on Trade in Information Technology Products (ITA)[6] is a more modern example on how tariffs may be determined by members. In order to create market access opportunities for information technology products, participating members agree to 'eliminate customs duties and other duties and charges of any kind within the meaning of [GATT] Article II:1(b)' with respect to categories of information technology products and specific information technology products contained in the Declaration's Annex.[7] However, agreed duty eliminations are only to be implemented once members representing 90 per cent of world trade in technology products accede to the Agreement.[8] As of April 2015, eighty parties, representing approximately 96 per cent of world trade in information technology products, have acceded to the ITA.[9] A similar approach is currently used to reduce tariffs with regard to 'green goods'.[10]

GATT's transactional approach has been institutionalized by its Article XXVIII*bis*. It reflects the expectation of the contracting parties that the 'binding' of (import) tariff rates would become the starting point of a downward spiral leading to lower tariff rates.[11] History has proven this expectation right: At the time of writing, the major trading nations in the developed world have bound the tariffs of all (or nearly all)[12] traded products.[13] The average import tariff rate in the developed world is less than

[4] *Turkey—Textiles* (Panel), para. 9.63.

[5] cf. in some detail on both ground rules and practice, including the (at the time of writing) still ongoing Doha Round, Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization*, 3rd edn. (Cambridge University Press, 2013) 429–38.

[6] Ministerial Declaration on Trade in Information Technology Products (ITA), 13 December 1996, para. 1. The legal status of the Information Technology Agreement among the WTO agreements has been discussed in *EC—IT Products* (Panel), paras. 7.372–7.384.

[7] ITA, para. 2.

[8] ITA Annex, para. (4).

[9] WTO, Committee of Participants on the Expansion of Trade in Information Technology Products, Status of Implementation, Note by the Secretariat, G/IT/1/Rev. 53, 27 April 2015; see also WTO Secretariat, 15 Years of the Information Technology Agreement—Trade, Innovation and Global Production Networks, Geneva, 2012, p. 3 *et seq.*

[10] United Nations Conference on Trade and Development, WTO Negotiations on Environmental Goods: Selected Technical Issues, New York and Geneva, 2011 (UNCTAD/DITC/TED/2011/1); Mahesh Sugathan, Addressing Energy Efficiency Products in the Environmental Goods Agreement: Issues, Challenges and the Way Forward, ICTSD Issue Paper 20, March 2015.

[11] John H. Jackson, *World Trade and the Law of the GATT* (Bobbs-Merrill Company, 1969) 35 *et seq.*

[12] See the Current Situation of Schedules of WTO members, available at <http://www.wto.org>.

[13] As listed in a nomenclature ('Harmonized System') developed within the framework of the World Customs Organization (WCO), an international governmental organization.

4 per cent, more a nuisance than a real trade impediment (see *infra*).[14] This result was achieved in eight pre-WTO trade negotiation rounds, the latest one being the Uruguay Round that led to the establishment of the World Trade Organization.[15] Article II:2, sentence 2 of the WTO Agreement now attributes to the WTO the role of fostering such regular trade negotiations, a task that has proven to be a very difficult one.[16]

In 1969, John Jackson's first comprehensive book on the law of the GATT called the law of Article II and of tariff bindings 'the central obligation of GATT'.[17] Forty-five years later—at a time when the proliferation of preferential trade agreements (PTAs) has somewhat diminished the effectiveness of the GATT's non-discrimination obligations—this evaluation is as appropriate as it was then. Whereas the full benefit of MFN treatment may be endangered due to GATT Article XXIV-conforming free trade agreements (FTAs),[18] the tariff bindings entered into on the basis of GATT Article II provide certainty and predictability as to the maximum costs of market access.[19] Note that Article II, together with Article I, form Part I of the General Agreement,[20] which constitutes the fundament for the remainder of GATT.

GATT Article II sets up a mechanism which *allows* members to establish maximum tariff rates for specified products. This exercise is completely voluntary: whereas the European Union (EU) or the United States have bound tariffs for all product categories, some states have only bound their maximum tariffs for a very small number of products.[21] However, once the mechanism of Article II has been activated by scheduling maximum tariff(s) for one or more product categories, binding obligations ensue (GATT Article II:1): the scheduled maximum tariff rates are a promise *erga omnes partes contractantes* and, pursuant to GATT Article II:7, an integral part of the GATT.

[14] WTO Trade Policy Review Division, 'Multilateral Approaches to Market Access Negotiations', Staff Working paper, TPRD-98-02, 1998, 2; however, tariff peaks continue to exist, not just for agricultural products (cf. Art. 4.2 of the AoA), but also for industrial products such as textiles, shoes, and transport equipment. cf. WTO Secretariat, 'Market Access: Unfinished Business', Special Studies Series 6, 2001, 12 *et seq*.

[15] Gilbert R. Winham, 'The Evolution of the World Trading System' in Daniel Bethlehem, Donald McRae, Rodney Neufeld, and Isabelle Van Damme, eds., *The Oxford Handbook of International Trade Law* (Oxford: Oxford University Press, 2009) 6–24.

[16] At the time of writing, the Doha Round has still not been concluded. Some intermediate results have been achieved at the Bali Ministerial Conference in 2014 and subsequent arrangements; cf. <https://www.wto.org/english/thewto_e/minist_e/mc9_e/balipackage_e.htm>.

[17] John H. Jackson, *World Trade and the Law of the GATT* (Bobbs-Merrill Company, 1969) 201.

[18] Note, that the terms FTAs and PTAs are used interchangeably.

[19] See *Argentina—Textiles and Apparel* (Appellate Body), para. 47: 'A basic object and purpose of the GATT 1994, as reflected in Article II, is to preserve the value of tariff concessions negotiated by a Member with its trading partners, and bound in that Member's Schedule.' As to the paradigm of security and predictability see *US—Section 301 Trade Act* (Panel), para. 7.75.

[20] GATT 1947 emphasized the importance of these two provisions by requiring consensus for their amendment in Art. XXX GATT 1947. GATT 1994 upholds this requirement (see Art. X:2 WTO Agreement). See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO. Procedures and Practices* (Cambridge: Cambridge University Press, 2001) 23.

[21] See WTO/ITC/UNCTAD, *World Tariff Profile 2014*, available at <https://www.wto.org/english/res_e/publications_e/world_tariff_profiles14_e.htm>.

It is important to realize that by leaving tariffs as the only legal means of market access restriction ('tariffication'), market access is not guaranteed: By establishing a prohibitively high tariff (in WTO parlance a 'tariff peak'),[22] an imported product would normally be too expensive to successfully compete with domestic 'like products'. Whereas such a 'tariff peak' would represent a de facto insurmountable restriction on market access, it would be perfectly compatible with a member's legal obligations under the GATT, provided the custom duty does not surpass the rate scheduled pursuant to Article II.[23] However, bound tariffs do provide transparency and, hence, predictability for traders. Because tariffs have proven to be easier to negotiate than any other trade impediment, they also have contributed to the success of the GATT 1947 trade negotiation rounds and thereby to the success of the multilateral trading system.

2.2 The definition of 'tariff'

It is somewhat ironic that the term 'tariff' is not defined by any provision of the General Agreement *on Tariffs* and Trade (GATT). However, its use in the Agreement sheds light on its meaning. In the text of the GATT, the term 'tariff' appears already in the preamble: Improvement of interstate economic relations is to be brought about by 'entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade'. In the same sense, GATT Article XIX:1 uses 'tariff concessions' as an example of 'obligations incurred by a [member] under this Agreement'. GATT Article XXIV:2 defines the term 'customs territory' as a 'territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territory with other territories'.

In these examples,[24] 'tariff' describes—implicitly or, as in Article XXVIII*bis*, explicitly—a state levy imposed on or in connection with the importation of a good, and is used as a synonym for 'customs duty'. In other words: tariffs are the price to be paid for a foreign product's market access, or to allow a product to cross borders;[25] it is not decisive *where* the payment is taking place.[26] Note, that the payment of a tariff constitutes a form *entry ticket* insofar as it buys access into a market in which imported goods will be treated even-handedly, pursuant to GATT Article III (see Chapter 7). In addition, three qualifications of the terms 'tariff' and 'customs duty' seem in order:

[22] In the Doha Ministerial Declaration (WT/MIN(01)/DEC/1, 20 November 2001), Ministers, *sub* para. 16, agreed to 'negotiations which shall aim . . . to reduce or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation . . . '.

[23] As regards the details of entering into tariff commitments see Alberta Fabbricotti, 'Art. XXVIII *bis* GATT' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011).

[24] cf. GATT Art. XXVIII*bis*: '[C]ustoms duties . . . constitute serious obstacles to trade; thus negotiations . . . , directed to the substantial reduction of . . . tariffs . . . are of great importance to the expansion of international trade.'

[25] cf. *EC—Poultry* (Appellate Body), para. 145: '[I]t is upon entry of a product into the customs territory, but before the product enters the domestic market that the obligation to pay customs duties . . . *accrues*' (emphasis added).

[26] *China—Auto Parts* (Appellate Body), para. 162.

First, 'tariff' may have two interrelated but distinct meanings. The term is used both for the product-specific rate (for instance: country A has a tariff of 10 per cent *ad valorem* for 'chicken breast') and a member's *body* of (individual) tariffs: in that case, the term *tariff(s)* describes the law(s) and regulation(s) which list (most of) the many customs duties (or 'tariffs') and are the basis for the work of the customs administration; a pertinent example is the EU's Common Customs Tariff (CCT).[27]

Secondly, while the focus in the GATT and the WTO was until recently on *import* tariffs (as market access restrictions), states may also charge a levy for *leaving* the country of production. Such *export tariffs* (also known as export duties or export taxes),[28] have remained largely unbound,[29] due to the lack of pertinent demands in past trade negotiation rounds.[30] Unless their use would amount to a quota, members are therefore free to use them: it is estimated that approximately one third of the WTO's membership is using them, mostly on commodities, in particular with regard to foodstuffs, oil, gas, and other raw materials.[31] Many regional trade arrangements specifically exclude them,[32] and so do many post-1994 protocols of accession.[33] Export tariffs share with import tariffs a significant protectionist potential: They may provide a competitive advantage to domestic industries that use the export-taxed input at a lower price than the foreign competitors.[34]

Thirdly, while tariffs can be defined as a form of tax on the crossing of the border (inbound, by the importing state on imported products, or outbound, by the exporting state on the exported product), the wording and structure of the GATT make clear that the generic tax that is called tariff (or custom duty or other duty and charges) is *not* a tax for the purposes of GATT Article III:2. Rather, it is a customs duty, addressed by Article II: Tariffs are *border measures*, imposed *because of* the crossing of the border,

[27] Council Regulation (EEC) No 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff, OJ L 256, 7 September 1987, 1. See, for a recent modification, Commission Implementing Regulation (EU) No 1101/2014 of 16 October 2014 amending Annex I to Council Regulation (EEC) No 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff, OJ L 312, 31 October 2014.

[28] See Working Party of the Trade Committee (prepared by Jun Kazeki), 'Analysis of Non-Tariff Measures: The Case of Export Duties', OECD Doc. TD/TC/WP(2002)54/FINAL, para. 5.

[29] Note, however, that in contrast to GATT Art. II:1(a), Art. II:1(b) does not apply to exports, as it specifically targets 'importations'.

[30] One of the more prominent exceptions being Australia, which accepted the request of the EC in the Uruguay Round, to forgo the right to export duties with regard to eleven minerals. With regard to the accession of new states this has changed. In particular China and Russia had to accept significant restrictions on their ability to raise export tariffs. cf. Report of the Working Party on the Accession of Russia, WT/ACC/RUS70, 17 November 2011, para. 635 *et seq*. and *China—Raw Materials* (Panel), para. 7.77 *et seq*.

[31] See *China—Raw Materials* and *China—Rare Earths*; cf. also Baris Karapinar, 'Export Restrictions and the WTO: "Regulatory Deficiency" or "Unintended Policy Space"', available at <https://www.wto.org/english/res_e/publications_e/wtr10_21may10_e.htm>.

[32] See, for example, TFEU Art. 25, NAFTA Art. 314.

[33] OECD Doc. TD/TC/WP(2002)54/FINAL, fn. 11, reports pertinent commitments of, inter alia, Bulgaria (1996), Latvia, Estonia (1999), Georgia, Croatia (2000), and most importantly, China in 2001.

[34] See *China—Raw Materials*, request for consultation by the European Communities (WT/DS/395/1) 25 June 2009 and request for consultation by the United States, WT/DS/394/1 (25 June 2009). In its Protocol of Accession, China undertakes to 'eliminate all taxes and charges applied to exports unless specifically provided for in Annex 6 [listing some eighty-four products] or applied in conformity with… [GATT] Article VIII.'

whereas GATT Article III covers *internal* measures that apply to imported products *after* customs clearance. This having been said, neither the place (at the border, or 2000 miles inland at an airport), nor 'the time in which a charge is collected' is decisive.[35]

The *China—Autos* case has reaffirmed the fundamental importance of the distinction between border measures and internal measures in the GATT system:[36]

> [W]hether a specific charge falls under Article II:1(b) or Article III:2 of the GATT 1994 must be [determined] . . . in the light of the characteristics of the measure and the circumstances of the case.[37] In many cases this will be a straightforward exercise. In others, the picture will be more mixed, and the challenge faced by a panel more complex. A panel must thoroughly scrutinize the measure before it, both in its design and in its operation, and identify its principal characteristics. Having done so, the panel must then seek to identify the leading or core features of the measure at issue, those that define its "centre of gravity" for purposes of characterizing the charge that it imposes as an ordinary customs duty or an internal charge. It is not surprising, and indeed to be expected, that the same measure may exhibit some characteristics that suggest it is a measure falling within the scope of Article II:1(b), and others suggesting it is a measure falling within the scope of Article III:2. In making its objective assessment of the applicability of specific provisions of the covered agreements to a measure properly before it, a panel must identify *all* relevant characteristics of the measure, and recognize which features are the most central to that measure itself, and which are to be accorded the most significance for purposes of characterizing the relevant charge and, thereby, properly determining the discipline(s) to which it is subject under the covered agreements.[38]

Whereas, according to the Appellate Body's jurisprudence, a financial levy can only be a customs duty pursuant to Article II or an internal measure pursuant to Article III:2, internal measures may be additionally (and exceptionally) captured by Article XI, if their effect is such that they create such a strong disincentive to accessing the market as to be equivalent to a quantitative restriction.[39]

2.3 Types of tariffs

According to the manner in which they are calculated, tariffs can be grouped into three main categories.

(1) *Specific tariffs* are based on a unit of measure such as the weight, volume, etc. of the goods. For example, the tariff for a litre of sparkling wine may be 2 CHF per bottle; the tariff for wheat may be RMB 10,000 per metric ton. Specific tariffs

[35] *China—Auto Parts* (Appellate Body), para. 162.

[36] *China—Auto Parts* (Appellate Body).

[37] Footnote in the original: 'In *India—Additional Import Duties*, the Appellate Body made a similar observation with respect to the issue of whether a measure falls under Article II:2(a) or the *Ad* Note to Article III. (Appellate Body Report, *India—Additional Import Duties*, footnote 304 to para. 153)'.

[38] *China—Auto Parts* (Appellate Body), para. 171.

[39] See *Argentina—Bovine Hides* (Panel).

have become an exceptional practice with regard to industrial goods,[40] while they remain a standard feature in tariff schedules for agricultural goods.[41]

(2) An *ad valorem tariff* is a tariff defined by the percentage[42] of the value of an imported item. For example, the tariff for red wine might be 10 per cent of the value of the product. Given that the tariff schedules are supposed to contribute to the predictability, clarity, and transparency of market access conditions, good reasons can be advanced for the view that an *ad valorem* tariff binding in the schedule should not allow members to apply a specific duty. However, the Appellate Body has viewed this as a baseless restriction on state sovereignty, as it is not explicitly mandated by the text of the GATT.[43] As *ad valorem* tariffs are more transparent and more suitable for negotiations, members of the WTO have decided to make the conversion of 'all non-*ad valorem* duties . . . to *ad valorem* equivalents on the basis of a methodology to be determined' an item for the Doha Round.[44]

(3) Various *combinations* of specific and *ad valorem* duties ('compound tariffs') are possible. In addition, *tariff quotas* (also referred to as tariff-rate quotas) have remained a popular feature of national customs law. For example, a 10 per cent *ad valorem* tariff for the first 50,000 tons of an imported product; once that threshold has been reached, a 15 per cent *ad valorem* tariff plus 200 € specific duty per ton.[45]

2.4 The purpose and effects of (import) tariffs

Tariffs are one of the oldest sources of revenue for states. Even in today's world, this has remained true for countries with an inefficient state administration, as tariffs are comparatively easy to collect: customs offices at the main points of entry can be established at low cost and manned with a comparatively small workforce. In contrast, tariffs have become largely irrelevant as an income source in the developed world.[46] They have remained, however, important as a means to protect domestic industries by changing the competitive relationship between domestic and imported goods: only the

[40] Switzerland, Thailand, and Sri Lanka remain notable exceptions.

[41] See WTO Secretariat, *Market Access*, n. 14 at 46 *et seq.* See pertinent efforts in the Doha Round negotiations with regard to agricultural goods, Doha Work Programme, Decision adopted by the General Council on 1 August 2004, WT/L/579, 2 August 2004, Annex B, para. 5: 'all non-*ad valorem* duties shall be converted to *ad valorem* equivalents on the basis of a methodology to be determined and bound in *ad valorem* terms'.

[42] *US—Gambling* (Appellate Body), para. 233: A 'bound duty rate will usually be above zero. Yet this does not mean that Article II:1(b) does not also refer to bound rates set at zero.'

[43] *Argentina—Textiles and Apparel* (Appellate Body), para. 55; see also relevant state practice which reveals that contracting parties have, in the past, not been reluctant to address the change in calculation method as potentially affecting the value of concessions: Working Party on Schedules, *Turkey—Transposition of Schedule XXXVIII*, B.I.S.D. 3S/126 (1955), para. 4.

[44] General Council, Decision of 1 August 2004 on the Doha Programme, WT/L/579, 2 August 2004, Annex B, para. 5.

[45] With respect to agricultural goods specific tariffs and compound tariffs have remained common.

[46] In the United States, tariffs finances between 1–2 per cent of the budget; in the EU (which has a very small budget, as the Member States remain responsible for most expenses, and taxes in general) the amount is less than 15 per cent. See <http://ec.europa.eu/budget/explained/budg_system/financing/fin_en.cfm>.

latter have to absorb the customs duties.[47] This is particularly evident when products are subjected to different tariffs, depending on where in the (value) chain of production they are being used. To give an example: agricultural products (such as cherries or nuts) are often subjected to high tariffs. However, if those products are being used exclusively for the production of another product, such as chocolates, the applicable rate is often very low or 'zero' in order to support domestic manufacturers. Another feature of the (WTO-compatible!)[48] protectionist purpose of tariffs are so-called tariff escalations. These serve the same purpose of keeping the import of raw materials and input cheap and rendering the import of competitors for value-added products expensive. A pertinent example would be a sweater-producing country (such as Turkey or the US) which may import cashmere wool and yarn at very low tariffs, but may impose significantly higher ones on cashmere *sweaters*.

Custom duties also serve as an instrument to achieve the rational allocation of scarce foreign exchange: If a country's foreign exchange reserves are too small to accommodate the importation of both sorely needed hydroelectric turbines and the more discretionary foreign-made luxury automobiles, a high tariff rate on the latter may be advantageous for the overall population. The downside, of course, are higher costs for consumers, a loss of consumption opportunities, and inefficient expansion of domestic production. Because tariffs raise the domestic price of imported products, domestic sellers gain and domestic buyers lose.[49]

2.5 Schedules of concessions

Pursuant to GATT Article II:1(a):

> Each contracting party shall accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.

The 'Schedule' (of concessions) mentioned in the quoted provision, but also in GATT Article II:7, lists all binding tariffs a WTO member has entered into.[50] With the exception of the members that form a customs union (such as, for example, Liechtenstein and Switzerland, or the twenty-eight EU Member States), all members have their own schedule. As GATT does not impose an *obligation* to bind tariffs, it would be perfectly possible for a member to have *no* schedule of concessions. However, if a member commits to not raise a product-specific tariff above a certain maximum

[47] In *India—Additional Import Duties* (Appellate Body), para. 159, the Appellate Body explained: 'Tariffs are legitimate instruments to accomplish certain *trade policy* or other objective, such as to generate… revenue.' They are legal, '[i]rrespective of the underlying objective'.

[48] Ibid.

[49] Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization*, n. 5, 425–6, list five arguments supporting the preference of tariffs: (1) transparency, (2) facilitation of trade negotiations, (3) the profit from the rise in import prices due to the market access restrictions at least also benefits the government, not just the importer, (4) tariffs are less likely to foster corruption, and (5) greater flexibility of tariffs which do not constitute an absolute barrier such as quotas.

[50] Whereas Art. II:1 lit. b and Art. II:1 lit. c determine the basic structure of members' schedules.

threshold, it does so by listing the product in question, together with the accepted maximum tariff in said schedule: for instance, a state may indicate that for the product category bicycles it will not charge more than 10 per cent. As GATT Article II:1(a) only prohibits the charging of duties exceeding the 'bound' tariffs, members may, of course, apply a tariff which remains below the bound level.[51] In fact, 'applied tariffs' are often lower than the 'bound tariffs' for a particular product.[52] In WTO negotiations parlance, the difference between 'bound' and 'applied' tariffs is called 'juice'. In today's tariff negotiations which often work with across-the-board reduction formulas, members with a significant reserve of 'juice' fare better than those members who have taken their applied levels as basis for their bound tariffs. This, in turn, has given rise to tariff reduction formulas that entail more significant reductions for members with significant reserves of 'juice'.[53]

Members' schedules of concessions differ significantly as to their substantive content: whereas OECD states tend to have bound the quasi-totality of all products at very low rates (on average), some developing countries have only bound their tariffs with regard to a small number of products, and not necessarily at low rates.[54] However, the format of these schedules is harmonized, subdividing them into four parts:

1. Part I deals with MFN concessions, that is, the commitments of a member extended to all other WTO members ('MFN duties'); it is split into two 'sections' which address agricultural products and non-agricultural products, respectively.[55]
2. Part II lists preferential concessions granted on the basis of the trade arrangements listed in the annexes to GATT Article I.[56] *These* preferential concessions

[51] *Argentina—Textiles and Apparel* (Appellate Body), para. 46.

[52] cf. the data in the yearly publication by WTO, ITC, and UNCTAD, *World Tariff Profiles*, n. 21.

[53] An excellent overview of the organization of tariff negotiations may be found in Van den Bossche and Zdouc, n. 5, at 431–8.

[54] Today, the research tool of choice is the WTO's website: <http://www.wto.org/english/tratop_e/schedules_e/goods_schedules_table_e.htm>. See also the GATT Council Decision, Introduction of a Loose-Leaf System for the Schedules of Tariff Concessions, adopted 26 March 1980, B.I.S.D. 27S/22 and its modification through the Decision of the (WTO) Council for Trade in Goods on the Establishment of Consolidated Loose-leaf Schedules, G/L/138, 29 November 1996.

[55] Tariff schedules list the pertinent Harmonized System (HS) tariff item number, followed by a description of the product. The Appellate Body has underlined the importance of this very sophisticated classification system: '[D]uring, as well as after the Uruguay Round negotiations, there was broad consensus among the GATT Contracting Parties to use the Harmonized System as the basis for their WTO Schedules . . . In our view, this consensus constitutes an "agreement" between WTO Members "relating to" the WTO Agreement that was made "in connection with the conclusion of" that Agreement within the meaning of Article 31(2)(a) of the Vienna Convention.' *EC—Chicken Cuts* (Appellate Body), para. 199; see also *EC—Computer Equipment* (Appellate Body), para. 89: '[T]he Uruguay Round tariff negotiations were held on the basis of the Harmonized System's nomenclature and that requests for, and offers of, concessions were normally made in terms of this nomenclature' (emphasis deleted).

The schedules then provide information on the tariff treatment of that product, i.e. its rate of duty, followed by the date of the entry into force of that concession. This product-related information is followed by information relevant for future trade negotiations: information on initial negotiation rights (INRs, important for the application of Art. XXVIII), information on when the concession was first incorporated into the pertinent member's schedule, and information on prior ownership of INRs. Finally, on the basis of the Understanding on the Interpretation of Art. II:1(b), schedules list 'other duties and charges' in the sense of Art. II:1 lit. b 2nd sentence, and, in the case of agricultural products, special safeguards.

[56] No bindings for Part II were scheduled in the Tokyo and Uruguay Rounds; see Edmond McGovern, *International Trade Regulation* (Exeter: Globefield Press, 2008) 5.11–5.13.

may not be confounded with the many 'preferential duties' that members receive as a result of the large number of free trade agreements concluded after 1994, often establishing duties at 0 per cent rates.[57] FTAs are exempted by Article XXIV from the disciplines of Articles I and II, in particular, and thus allow discrimination between WTO members.[58] In addition, the so-called Enabling Clause—a decision of the GATT contracting parties that has been expressly incorporated into the GATT (and thus has become an integral part of the WTO Agreement) by virtue of paragraph 1 lit. (b) (iv) of the Introductory Note to GATT 1994[59]—allows preferential treatment of developing countries and LDCs. As these preferential trade agreements are not listed in the schedules, efforts of the WTO to find other means to make FTA arrangements transparent and public are most welcome.[60]

3. Part III of a member's schedule contains its concessions on non-tariff measures.
4. Part IV deals with specific commitments on domestic support and export subsidies on agricultural products.

As GATT Article II:7 renders schedules 'an integral part' of the GATT—itself a covered agreement within the meaning of DSU Article 1—they are subject to WTO adjudication and interpretation.[61] Therefore, the Appellate Body rejected an interpretative approach which focused on the legitimate expectations of the benefiting members, rather than on employing an interpretation on the basis of Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT) which focuses on the understanding of *all* parties involved in the pertinent negotiations.[62] Scheduled concessions have to be compatible with the WTO Agreement (and all its constituent parts, such as the GATT or the Agreement on Agriculture).[63]

[57] A snapshot of many of the FTAs in force notified to the WTO can be found at <http://www.worldtradelaw.net/databases/ftas.php>.

[58] See Chapter 14 for more detail; see also Michael Trebilcock and Michael Fishbein, 'International Trade: Barriers to Trade' in Andrew T. Guzman and Alan O. Sykes, eds., *Research Handbook in International Economic Law* (Edward Elgar, 2007) 16 *et seq*.; Joel P. Trachtman, 'International Trade: Regionalism' in Andrew T. Guzman and Alan O. Sykes, eds., *Research Handbook in International Economic Law* (Edward Elgar, 2007) 151 *et seq*.

[59] Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries, Decision of 28 November 1979, L/4903, 3 December 1979. The Appellate Body has addressed the Enabling Clause's legal status in *EC—Tariff Preferences* (Appellate Body), para. 90 and fn. 192.

[60] See Anne Giula Tevini, 'Understanding on the Interpretation of Article XXIV of the GATT 1994' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011), n. 2 at paras. 47–51. See also the pertinent efforts of the WTO, in particular the Regional Trade Agreements Information System (RTA-IS), <http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx>.

[61] Like the GATT, they have to be *interpreted* according to the rules of treaty interpretation as enshrined in the Vienna Convention on the Law of Treaties (VCLT); cf. Isabelle Van Damme, 'The Interpretation of Schedules of Commitments' (2007) *Journal of World Trade* 41, 1–52, who also points out the hybrid character of schedules—between treaty proper and unilateral commitment.

[62] *EC—Chicken Cuts* (Appellate Body), para. 239; *EC—Computer Equipment* (Appellate Body), paras. 84, 109. For the interpretation of tariff items it must be noted that the HS provides for elaborate interpretation rules and a dispute settlement procedure.

[63] *EC—Poultry* (Appellate Body), para. 98; *EC—Export Subsidies on Sugar* (Appellate Body), para. 220; *EC—Bananas III* (Appellate Body), para. 154; *EC—Computer Equipment* (Appellate Body), paras. 82–4, 95; see McGovern, n. 56 at 5.11–5.16. Of course, consistent and uniform state practice will reflect common understanding of the parties.

Tariff schedules follow the format established by the Harmonized Commodity Description and Coding System ('Harmonized System' or HS), developed by the World Customs Organization. The importance of the Harmonized System for the appropriate understanding of the schedules' content cannot be overstated, as there is

> broad consensus among the GATT Contracting Parties to *use* the Harmonized System as the basis for their WTO Schedules, notably with respect to agricultural products.... [T]his consensus constitutes an "agreement" between WTO Members "relating to" the *WTO Agreement* that was "made in connection with the conclusion of" that Agreement, within the meaning of Article 31(2)(a) of the *Vienna Convention*.... [Therefore] the Harmonized System is relevant for purposes of interpreting tariff commitments in the WTO Members' Schedules.[64]

Whereas the Appellate Body did not find it necessary to determine whether the Harmonized System could constitute a 'relevant rule of international law', pursuant to Article 31(3)(c) of the Vienna Convention,[65] it did indicate

> that the classification practice in the European Communities during the Uruguay Round is part of "the circumstances of [the] conclusion" of the *WTO Agreement* and may be used as a supplementary means of interpretation within the meaning of Article 32 of the *Vienna Convention*. However... the value of the classification practice as a supplementary means of interpretation is subject to certain qualifications discussed below.[66]

Despite the fact that this 'language' of the schedules is developed, administered, and changed in the WCO, WTO dispute settlement organs have so far not externalized the task of finding the appropriate understanding of a pertinent customs classification to the specialized dispute settlement organs of the WCO.[67]

Rather, the Appellate Body and Panels have undertaken for themselves to find the 'true meaning' of a scheduled HS product category. The two most prominent cases so far dealt (1) with the issue whether computer equipment associated with local area networks (LAN) were 'Automatic Data Processing' (ADP) machines or rather fell under 'Telecommunication Apparatus' and (2) with the issue whether and when salted chicken parts were indeed 'salted' or rather 'fresh' for the purpose of the Harmonized System nomenclature.[68] As the bound rates for different product categories vary, the decision whether a given product falls under one or another customs classification entails far-reaching economic consequences. In the *Chicken* case, only the rate for 'salted meat' allowed the (Brazilian and Thai) chicken industry importation into the EU at competitive prices, while the tariff rate for fresh chicken meat would have rendered export into the EU moot, due to the higher price. As a consequence, the

[64] *EC—Chicken Cuts* (Appellate Body), para. 199. [65] Ibid. fn. 384.
[66] *EC—Computer Equipment* (Appellate Body), para. 92.
[67] cf. Marina Foltea, *International Organizations in WTO Dispute Settlement* (Cambridge University Press, 2014) 224 *et seq*.
[68] See *EC—Computer Equipment* (Appellate Body) and *EC—Chicken Cuts* (Appellate Body).

outcome of this dispute was of existential importance for the chicken growers of all parties to the dispute.[69]

2.6 Tariffs bindings proper

GATT Article II:1(a) requires the WTO members to accord tariff 'treatment no less favourable' than that provided for in their schedules, making the tariff ceilings contained in those schedules legally binding. The following provision, Article II:1(b), provides that imported products shall be exempt from 'ordinary customs duties' (OCDs) and 'all other duties and charges of any kind' (ODCs) *in excess of* those notified in the schedule submitted by a WTO member. In *Argentina—Textiles and Apparel*, the Appellate Body described the second provision therefore as the regulation of a

> specific kind of practice that will always be inconsistent with the [general prohibition against according treatment less favourable to imports than that provided for in a Member's schedule, contained in] paragraph a: that is the application of ordinary customs duties in excess of those provided for in the schedule.[70]

Article II:1(b) subjects the obligation to 'exempt from ordinary customs duties ... to the terms, conditions or qualifications set forth in that Schedule'. Therefore, the concession made in the schedule may be qualified and limited, pursuant to the 'terms, conditions or qualifications set forth'.[71] However, this flexibility does not affect the fundamental tenet underlying the scheduling of tariff bindings that WTO members are only allowed to 'incorporate into their Schedules acts yielding rights under the General Agreement but not acts diminishing obligations under that Agreement'.[72] Therefore, a reservation in the US schedule providing for the right to impose quotas on sugar imports was held to be without legal effect as schedules are supposed to legalize what is otherwise incompatible with the GATT, in that case its Article XI:1.[73]

[69] See *EC—Chicken Cuts* (Appellate Body). The well-known early GATT Panel report, *Treatment by Germany of Imports of Sardines*, G/26, adopted 31 October 1952, B.I.S.D. 1S/53, (hereinafter: *Germany—Sardines*) addressed the question whether the use of more specific sub-categories of sardines was a violation of commitments entered into under Art. II. As the sub-classification in question had existed at the time of the negotiations, without Germany at that point having entered into any concession, no Art. II violation had occurred. However, the Panel reasoned that by granting more favourable treatment to similar imported products Germany had upset the competitive position of the imported product concerned and exceptionally upheld the non-violation complaint.

[70] *Argentina—Textiles and Apparel* (Appellate Body), paras. 45 (and 55), finding that Argentina had acted inconsistently with Art. II:1(b) by applying a type of duty different from the type provided for in its schedule, because the application thereof resulted in 'ordinary customs duties' being levied in excess of those provided for in its schedule.

[71] '[T]he ordinary meaning of the phrase "subject to" is that such concessions are ... *subordinated to*, and are, therefore, *qualified by*, any "terms, conditions or qualifications"'; *Canada—Dairy* (Appellate Body), para. 134.

[72] GATT Panel report, *United States Restrictions on Imports of Sugar*, L/6514, adopted 22 June 1989, B.I.S.D. 36S/331, para. 5.2 (1990), confirmed by the Appellate Body in *EC—Bananas III* (Appellate Body), para. 154 and *EC—Poultry* (Appellate Body), para. 98.

[73] Ibid. para. 6.1, at 344.

2.7 Renegotiation of schedules and other tariff modifications

Like every treaty obligation, the commitments entered into force pursuant to Article II may be modified consensually by the contracting parties. Thus, GATT Article XXVIII and the Understanding on Article XXVIII privilege the party wishing to modify or even withdraw its tariff concessions, as the desired outcome is possible without the consensus of *all* GATT contracting parties: pursuant to GATT Article XXVIII:1, each pertinently inclined member may, 'by negotiation or agreement . . . modify or withdraw a concession included in the appropriate schedule annexed to this Agreement,' provided that the members 'primarily concerned' agree. This sub group of the membership includes members 'with which such concession [were] initially negotiated' (Article XXVIII:1)[74] and any other member having a 'principal supplying interest' (as determined by the Council).[75] If the negotiations to achieve a consensual rebalancing of rights and obligations 'in order to maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in this agreement prior to such negotiations'[76] fail, GATT permits departure from the commitment entered into, pursuant to Article XXVIII:3 (a). In that case,

> any contracting party with which such concession was initially negotiated [and] any contracting party determined under paragraph 1 to have a principal supplying interest and any contracting party determined under paragraph 1 to have a substantial interest shall then be free not later than six months after such action is taken, to withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is received by the contracting parties, substantially equivalent concessions initially negotiated with the applicant contracting party.

Other opportunities for re-negotiation include the opening of new negotiations three years after the successful conclusion of tariff negotiations,[77] special circumstance negotiations,[78] re-negotiations by developing countries,[79] and a new round of trade negotiations.[80]

[74] These hold the 'Initial Negotiating Rights'; the concept of INR holders, is expanded in § 7 of the Understanding on the Interpretation of Article XXVIII.

[75] Whether members have a 'principal supplying interest' is determined on the basis of criteria contained in paras 1.4 and 1.5 of the *Ad* Note to Art. XXVIII and focusing on import and export shares. According to para. 1(7) of the *Ad* Note to Art. XXVIII 'the expression "substantial interest" is not capable of a precise definition and accordingly may present difficulties for the [members]. It is, however, intended to be construed to cover only those contracting parties which have, or in the absence of discriminatory quantitative restrictions affecting their exports could reasonably be expected to have a significant share in the market of the contracting party seeking to modify or withdraw the concession'. In practice, it is recognized that an import share of more than 10 per cent is enough to meet this condition. For further reading, see GATT Doc. TAR/M/16, 4 October 1985.

[76] cf. GATT Art. XXVIII, the *Ad* Note to Art. XXVIII, the Understanding on the Interpretation of Article XXVIII and the Procedures for Modification and Rectification of Schedules of Tariff Concessions.

[77] cf. Art. XXVIII, paras. 1, 2, 3, and 5. A party may reserve the right of re-negotiation within the three-year period, under para. 5 of the said Article.

[78] Art. XXVIII:4 deals with the re-negotiations at any time in special circumstances, when authorized by the General Council of the WTO.

[79] cf. Art. XVIII:7, in order to promote the establishment of a particular industry with a view to raising the general standard of living of its people.

[80] GATT Art. XXVIII*bis*.

Tariffs may also be modified upon the occurrence of any one of the following circumstances or events: (1) Withdrawal of a WTO member,[81] (2) compensatory modifications as a result of the formation or entry into a regional economic union,[82] (3) invocation of the escape clause,[83] (4) balance of payments difficulties,[84] (5) waivers,[85] and, finally, (6) sanctions.[86]

Countervailing duties would also fall into this category, but are explicitly exempted from the coverage of Article II.[87] Of course, nothing prevents a WTO member from *lowering* tariffs unilaterally or as a result of bilateral negotiations. The MFN obligation, however, requires WTO members to extend the benefit of the new status quo to all other members.

2.8 Classification of goods

The GATT does not address the issue of customs classification directly. However, international trade, and also trade negotiations, are greatly facilitated by the use of harmonized tariff classifications. To this end, a Customs Cooperation Council was established in 1952.[88] This organization, now named the World Customs Organization (WCO), develops rules on customs procedures and provides advice and assistance to customs services. Whereas a very limited number of WTO members have chosen to stay out of the WCO, all tariff schedules use the WCO's product nomenclature, the so-called Harmonized System (HS).[89] Indeed, the HS has become the common language for both negotiators and appliers of tariff schedules.[90]

[81] Art. XXVII. [82] Art. XXIV:6 requires compensatory adjustment.

[83] In the course of temporary safeguard action under GATT Art. XIX. [84] GATT Art. XII.

[85] Art. XXV; Art. IX:3 of the Agreement Establishing the WTO.

[86] Art. XXIII of the Agreement Establishing the WTO.

[87] Art. II, para. 2 reads in pertinent parts: '2. Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product: . . . (*b*) any anti-dumping or countervailing duty applied consistently with the provisions of Article VI'.

[88] Convention Establishing a Customs Cooperation Council, Brussels, 15 December 1950, 157 U.N.T.S. 129 (entered into force 4 November 1952).

[89] It contains more than 5,000 six-digit (expandable) subheadings, grouped in twenty-one sections covering ninety-nine chapters (not all of them yet used): According to the Harmonized System, all products are captured by twenty-one sections, encompassing ninety-nine chapters in total: Section I (chapters 1 to 5, live animals and animal products); Section II (chapters 6 to 14, vegetable products); Section III (chapter 15, animal or vegetable fats and oils); Section IV (chapters 16 to 24, prepared foodstuffs, beverages and spirits, tobacco); Section V (chapters 25 to 27, mineral products); Section VI (chapters 28 to 38, chemical products); Section VII (chapters 39 to 40, plastics and rubber); Section VIII (chapters 41 to 43, leather and travel goods); Section IX (chapters 44 to 46, wood, charcoal, cork); Section X (chapters 47 to 49, wood pulp, paper, and paperboard articles); Section XI (chapters 50 to 63, textiles and textile products); Section XII (chapters 64 to 67, footwear, umbrellas, and artificial flowers); Section XIII (chapters 68 to 70, stone, cement, ceramic, and glass); Section XIV (chapter 71, pearls and precious metals); Section XV (chapters 72 to 83, base metals); Section XVI (chapters 84 to 85, electrical machinery); Section XVII (chapters 86 to 89, vehicles, aircraft, and vessels); Section XVIII (chapters 90 to 92, optical instruments, clocks and watches, and musical instruments); Section XIX (chapter 93, arms and ammunition); Section XX (chapters 94 to 96, furniture, toys, and miscellaneous manufactured articles); and Section XXI (chapter 97, works of art and antiques). See International Convention on the Harmonized Commodity Description and Coding System (with Annex), as amended by the Protocol of Amendment of 24 June 1986, 14 June 1983, U.N.T.S. 1503 (1988), 167.

[90] *EC—Chicken Cuts* (Appellate Body), para. 198.

Pursuant to Articles II:3 and II:5, reclassifications may not impair the value of tariff concessions.[91] This does not limit the right of members to choose freely their system of classifying goods (for the time being a rather theoretical option, as the HS is the commonly used system) and to add sub-categories for which the HS specifically leaves room. Such a reclassification may involve differentiating between otherwise 'like' products, and maybe constitute a violation of GATT Article I, which prohibits the discriminatory treatment of 'like' products.[92] In the same vein, the development of new products that often show similarities to various pre-existing products, may prove to be problematic. Depending on which similarities influence the customs classification, significant market access impediments may be created.[93]

Finally, a reclassification may deprive WTO members of the value of trade concessions they reasonably expected. While such measure would not appear to be technically a violation, it would nevertheless nullify or impair a trade concession. In such a case, the aggrieved party may have a right to appropriate redress.[94]

2.9 Other duties and charges

According to Article II:1 lit. b, ordinary customs duties have an unruly sibling, the 'other duties and charges' (ODCs). This category of financial levies shares with the OCDs the trigger mechanism—ODCs, like OCDs, are imposed 'on the importation' of a product. However, they are also imposed 'in connection with the importation' of a product.[95] While there is consensus that ODCs form 'a residual category encompassing

[91] GATT Arts. II:3 and II:5 read: '3. No contracting party shall alter its method of determining dutiable value . . . so as to impair the value of any of the concessions provided for in the appropriate Schedule annexed to this Agreement . . . 5. If any contracting party considers that a product is not receiving from another contracting party the treatment which the first contracting party believes to have been contemplated by a concession provided for in the appropriate Schedule annexed to this Agreement, it shall bring the matter directly to the attention of the other contracting party. If the latter agrees that the treatment contemplated was that claimed by the first contracting party, but declares that such treatment cannot be accorded because a court or other proper authority has ruled to the effect that the product involved cannot be classified under the tariff laws of such contracting party so as to permit the treatment contemplated in this Agreement, the two contracting parties, together with any other contracting parties substantially interested, shall enter promptly into further negotiations with a view to a compensatory adjustment of the matter.'

[92] See *Spain—Tariff Treatment of Unroasted Coffee*, paras. 4.4–4.10 (concluding that Spain's tariff sub-classification of unroasted coffee discriminated against unroasted coffee from Brazil in violation of GATT Art. I:1). But GATT Panel report, *Canada/Japan—Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber*, L/6470, adopted 19 July 1989, B.I.S.D. 36S/167 (upholding Japan's classification system for lumber of species of coniferous trees).

[93] *Greek Increase in Bound Duty*, Report by the Group of Experts, GATT Doc. L/580 (9 November 1956). See, more recently, both the Appellate Body and Panel reports in *EC—Computer Equipment* and *EC—IT Products* (Panel).

[94] See *Germany—Sardines*, n. 69, paras. 17–18, at 59 (concluding that Germany's treatment of imports of sardines substantially reduced the value of the concessions obtained by Norway and, therefore, impaired a benefit accruing to Norway under the GATT). But see Appellate Body report, *EC—Computer Equipment*, paras. 107, 111(b) (concluding that the EC's reclassification of LAN equipment by treating such equipment as telecommunications equipment instead of ADP machines was consistent with GATT Art. II:1); *Canada—Dairy* (Appellate Body), paras. 125–43.

[95] In *India—Additional Import Duties*, the Panel took note of the 'parallelism' between the two sentences of Art. II:1 lit. b and opined that this parallelism 'strongly suggests that . . . the charges intended to be covered by the two provisions are charges of the same kind'. *India—Additional Import Duties*, WT/DS360/R, para. 7.128.

financial charges not "ordinary customs duties"'[96] and that ODCs like OCDs are 'border measures'[97] and hence a form of tariff barrier,[98] it is equally recognized that the different criteria in the two sentences of Article II:1 lit. b render them related, but distinct categories.[99] In *Chile—Price Band System*, the Appellate Body emphasized as much: 'Ordinary customs duties are governed by the first sentence of Article II:1(b), they are not relevant to the second sentence.'[100] Note, that the second sentence of Article II:1 lit. b not only addresses charges levied 'in connection with' the importation, but also refers to charges 'of any kind', as the Appellate Body pointed out in *India—Additional Import Duties*.[101]

GATT and WTO dispute settlement organs have held import surcharges—that is, levies imposed on imported products in addition to OCDs—to be ODCs.[102] Examples are, inter alia, statistical taxes imposed to finance the collection of statistical data, customs user fees which are not equivalent to the service rendered,[103] a foreign exchange fee, and a 'transitional surcharge'.[104] Contracting parties and (later) members have also had 'such classes of measures as "import surcharges", "revenue duties", "special import taxes", "economic development taxes", and import/security deposits to name just a few.'[105]

The Secretariat's 1989 evaluation of the matter still reflects the pertinent state of affairs: on the one hand, it has indeed been shown to 'be impossible . . . to draw up an

[96] '[T]he duties and charges covered by the second sentence of Article II:1(b) are "defined in relation to" duties covered by the first sentence of Article II:1(b), such that ODCs encompass only duties and charges that are not OCDs': *India—Additional Import Duties* (Appellate Body), para. 151.

[97] *China—Auto Parts* (Appellate Body), para. 141: 'It seems to us that an examination of whether a particular charge is an internal charge or a border measure involves consideration of all three types of charges, that is: ordinary customs duties under the first sentence of Article II:1(b); other duties and charges under the second sentence of Article II:1(b); and internal charges and taxes under Article III:2.' Ibid. para. 164: '[T]he criteria contained in Article II:1(b) and Article III:2 . . . distinguish a border measure from an internal charge under the GATT 1994'.

[98] See as the latest example of viewing OCDs and ODCs perhaps not as 'necessarily of a similar kind' (*India—Additional Import Duties*, (Appellate Body), para. 157), but as closely related para. 2 of the Ministerial Declaration on Trade in Information Technology Products, WT/MIN(96)/16, 13 December 1996 in which ministers declare to 'bind and eliminate custom duties and charges of any kind, within the meaning of Article II:1(b) of the General Agreement on Tariffs and Trade 1994'.

[99] See, for example, *Chile—Price Band System*, (Panel), para. 7.52.

[100] *Chile—Price Band System* (Appellate Body), para. 156.

[101] *India—Additional Import Duties* (Appellate Body), para. 158; the *travaux préparatoires* offer only limited help with regard to clarifying the meaning of the term. During the negotiation of the GATT 1947 it was understood that a government levy would be an import charge (rather than an internal tax) if (a) it was collected at the time of, and as a condition to, the entry of the goods, and (b) it applied exclusively to imported products without being related to similar charges collected internally on like domestic products. cf. ICITO/I/8, para. 42 f.

[102] See, for example, Panel report, *Korea—Beef (Australia)*, B.I.S.D. 36S/202, para. 102 *et seq*.

[103] Panel report, *US—Custom User Fee*, B.I.S.D. 35S/245, para. 70 *et seq*.

[104] *Dominican Republic—Import and Sale of Cigarettes* (Panel), paras. 7.22 *et seq*., 7.106 *et seq*.

[105] See Communication from New Zealand on Article II:1(b), Group of Negotiations on Goods (GATT), Negotiating Group on GATT Articles, GATT Doc. MTN.GNG/NG7/W/47, 28 June 1988. Other examples mentioned in the literature are primage duties, charges on transfers of payments, and import deposit schemes (which oblige importers to deposit a percentage of the value of the transaction with the state or its agents), Raj Bhala, *Modern GATT Law: A Treatise on the Law and Political Economy of the General Agreement on Tariffs and Trade and Other World Trade Organisation Agreements*, 2nd edn. (London: Sweet & Maxwell, Thomson Reuters, 2013) 283–4.

exhaustive list of ODCs which do fall under the purview of Article II:1(b), since it is always possible for governments to invent new charges. Indeed, an attempt to an exhaustive list would create the false impression that charges omitted from it, or newly invented, were exempt from the Article II:1(b) obligation'.[106] On the other hand, the Appellate Body has so far refrained from developing a general definition of the term ODC. In *Chile—Price Band System*, it rejected the position of the Panel without proposing an alternative. The Panel had opined that ODCs encompass all charges based not on the product itself—that is, its market value, its specific volume weight, or quantity—but on exogenous factors such as world prices or average prices.[107]

With the Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994 (hereinafter: 'the Understanding'), members have clarified in an authoritative manner what part of the practice under the GATT 1947 is to be continued and what is to be changed.

The text of the Understanding is, to a large extent, self-explanatory. In essence, it establishes obligations that any ODC has to meet in order not to be viewed as violating a member's obligation under Article II:1 lit. b. Members are now obliged to list their ODCs in much the same way as they register their tariff commitments in schedules: the 'nature and level of any "other duties or charges" levied on bound tariff items . . . shall be recorded in the Schedules of concessions . . . against the tariff item to which they apply' (paragraph 1 of the Understanding). This obligation forces members which wish to grandfather ODCs for their tariff bindings to include them in their schedules. Otherwise they are '*ipso facto* GATT-inconsistent'.[108]

To sum up: due to the Understanding, ODCs 'are permitted only when their nature and level are recorded in a Member's Schedule, they do not exceed the level recorded in such Schedule, and they existed on the relevant date specified in the Understanding on Article II:1(b) of the General Agreement on Tariffs and Trade 1994.'[109]

[106] GATT Doc. MTN.GNG/NG7/W/53, 2 October 1989, para. 4.

[107] *Chile—Price Band System* (Panel), para. 7.52. See *Chile—Price Band System* (Appellate Body), para. 264 *et seq*., in particular para. 273. It seems that the Panel had drawn on *Hoda*, n. 20 at 20–1 (para. 9.): 'As a broad definition of "other duties and charges" it has been accepted that only those levies that discriminate against imports are covered, e.g. stamp duty, development tax, revenue duty etc. In GATT 1947 panels, import deposit schemes and charges on transfer of payments imposed by governments have also been found to be covered by the limitation on imposition of ODCs in respect of the products on which tariff commitments have been made.'

[108] Para. 7 of the Understanding further specifies that the members have agreed to a mandatory standstill: they are not allowed to raise ODCs beyond the level promised when they joined the WTO or add new ones. Thus, a member can utilize ODCs only to the extent that they have been duly registered as being in place, either when the member joined the WTO; see *Chile—Price Band System* (Panel), paras. 7.107–7.108. While the Appellate Body reversed the finding related to Art. II:1 lit. b, it did not take issue with this methodologically unassailable reading of the Understanding. In *Dominican Republic—Import and Sale of Cigarettes* (Panel), paras. 7.88–7.89, the Panel equally refused to view the relevant ODCs—a transitional surcharge for economic stabilization and a foreign exchange fee—as being compatible with Art. II:1 lit. b, due to not having been scheduled in its notification to the WTO or whenever a tariff item has either been changed or established for the first time in a subsequent negotiation; see para. 2 of the Understanding.

[109] *China—Auto Parts* (Appellate Body), para. 141, fn. 209.

3. Non-Tariff Barriers I: Customs-Related Measures

In the preceding paragraphs, we presented an overview of the WTO law on tariffs. However, for traders the truth is in the customs house (regardless of whether it is located *on* the border, at the point of destination, or, rather is a de-localized virtual website). In order to determine the actual customs duty to be paid, customs officials must *(1)* determine the proper classification of the good. Thus, to take the example of the *Chicken Cuts* case, discussed earlier: is the chicken meat that is supposed to get clearance 'salted' (then falling into category c^1 with a bound tariff of, say, 1 per cent) or is it fresh (then falling into category c^2 with a bound tariff of, say, 10 per cent)? The difference, of course, determines the price and the success in the market. *(2)* Next, the value of the good is to be determined: is the value of the good, as indicated by the invoice, for example, US$1, or is it rather worth what the current market price is, for example, US$1,500? *(3)* Lastly, the origin of the good has to be determined: this is important because of the ubiquity of preferential arrangements, but also because of other factors such as trade remedies, which may be directed only against products from specific countries. All these issues are quite straightforward at an abstract policy level. They may, however, become very difficult at an operative level and may significantly affect access under the multilateral trading system. Therefore, a number of WTO agreements deal with these issues.

3.1 Agreement on Customs Valuation

Tariff values can be greatly skewed by differences or anomalies in the way the valuation of goods is calculated for customs purposes. This was already the state of play in 1947, and accordingly GATT Article VII[110] addresses the issue of 'Valuation for Customs Purposes'. Its paragraph 2(a) reads:

> The value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values.

The matter was taken up in a Tokyo Round Agreement in 1979[111] and then again by its successor, the Uruguay Round Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (Customs Valuation Agreement), which is an integral part of the WTO Agreement.[112]

The Agreement sets forth one standard, and five alternative measures of valuation.[113] As standard procedure, goods are to be assessed at their transaction value.[114]

[110] See also the *Ad* Note.

[111] Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994, GATT B.I.S.D. 26S/116 (1980); Protocol to the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade, GATT B.I.S.D. 26S/151 (1980).

[112] Art. II:2 of the WTO Agreement.

[113] *Colombia—Ports of Entry* (Panel), paras. 7.61–7.153.

[114] Art. 1 of the Customs Valuation Agreement.

Transaction value is the price actually paid or payable for the goods, with adjustments for certain specified costs that are incurred but not reflected in the price, such as selling commissions, packing costs, royalties, licence fees, and assets.[115] If the transaction value cannot be determined in cases in which there is no transaction value (for example, there is no sale or no invoice), or where the transaction value is not acceptable for the importing state as the customs value because the price has been distorted as a result of certain conditions (specified in Article 1),[116] the Customs Valuation Agreement prescribes five other methods of customs valuation, to be applied in the prescribed sequential order:[117]

Transaction Value of Identical Goods (Article 2): the customs value is determined on the basis of the transaction value of previously imported identical goods.

Transaction Value of Similar Goods (Article 3): the customs value is determined on the basis of the transaction value of previously imported similar goods.

Deductive Value Method (Article 5): the customs value is determined on the basis of the price at which the imported goods or identical or similar goods are sold to an unrelated buyer in the country of importation minus certain deductions.[118]

Computed Value Method (Article 6): the customs value is determined on the basis of the cost of production (value of the materials and fabrication), plus an amount for profits and general expenses.

Fall Back Method (Article 7): the customs value is determined using reasonable means consistent with the principles and general provisions of the Agreement and Article VII of GATT (available only if none of the other methods can be used).

The Customs Valuation Agreement eliminates previous valuation abuses, such as the use of the 'American Selling Price' by the United States before 1979.[119] It does not, however, eliminate all valuation disparities.[120] For example, some countries, amongst them Canada, Japan, and the United States, utilize the FOB (free on board) method of valuation for customs purposes, while most WTO members use a CIF[121] (cost, insurance, freight) method, permitted by Article 8.2 of the Customs Valuation Agreement. The use of the FOB valuation method results in lower US tariff charges than those levied by other countries under identical tariff rates.[122]

[115] Ibid. Art. 8.

[116] *Thailand—Cigarettes (Philippines)* (Panel), paras. 7.134–7.223.

[117] cf. Art. 4 of the Customs Valuation Agreement and the General Note in Annex 1; the order of the methods regulated in Arts. 5 and 6 may be changed.

[118] *Thailand—Cigarettes (Philippines)* (Panel), paras. 7.333–7.362.

[119] Art 7.2(a) of the Customs Valuation Agreement.

[120] For cases under the pre-WTO valuation rules, compare *Generra Sportswear Co. v United States*, 905 F.2d 377 (Fed. Cir. 1990) (textile quota charges properly included in transaction value) with Case 7/83, *Ospig Textilgesellschaft KGW. Ahlers v Hauptzollamt Bremen-Ost* [1984] E.C.R. 609 (quota charges not included in transaction value).

[121] FOB and CIF are both so-called Incoterms, established by the International Chamber of Commerce; Incoterms are internationally recognized and used worldwide in international contracts for the sale of goods.

[122] It is argued that the use of CIF by the United States would be unconstitutional because Article I, section 9, of the US Constitution forbids a preference to the ports of one state over another and Article I, section 8, requires import duties to be uniform throughout the United States. Whether CIF valuation would violate the uniformity clause has never been decided.

3.2 Customs fees and formalities connected with importation and exportation

The GATT requires customs fees and charges[123] to be limited to the approximate cost of services rendered.[124] Fees and charges that represent 'indirect protection to domestic products or a taxation of imports' are prohibited.[125] This rule was applied in *US—Customs User Fee*, in which a GATT Panel held that the US *ad valorem* system caused fees to be levied in excess of the cost of services rendered.[126] The United States subsequently adopted a new fee structure to comply with the ruling.[127]

GATT Article VIII further obliges the members to reduce the complexity of customs formalities,[128] including the diversity of fees[129] and to abstain from 'substantial' penalties for minor customs breaches.[130]

3.3 Agreement on Import Licensing Procedures

The Agreement on Import Licensing Procedures (Import Licensing Agreement) is designed to minimize the undesirable consequences of GATT-compatible import licensing which Article 1 defines as administrative procedures

> used for the operation of importing licensing regimes requiring the submission of an application or other documentation (other than that required for customs purposes) to the relevant administrative body as a prior condition for importation into the customs territory of the importing Member.

In case of conflict, the Agreement prevails over GATT Article X:3(a) as it 'deals specifically, and in detail, with the administration of import licensing procedure'.[131] The following ground rules apply: Import licensing procedures shall be applied neutrally and administered in a fair and equitable manner (Article 1.3).[132] In particular,

[123] Which explicitly does not include (i) import and export duties; and (ii) internal taxes within the scope of GATT 1994 Art. III. It also applies to import and export formalities. Typical fees and charges include licence fees and inspection fees, while import-related formalities refer to requirements relating to the documentation needed for import and customs clearance.

[124] GATT Arts. II:2(c) and VIII:1(a).

[125] GATT Art. VIII:1(a); they also shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes.

[126] GATT Panel report, *US—Customs User Fee*, L/6264, adopted 2 February 1988, B.I.S.D. 35S/245.

[127] US Customs and Trade Act of 1990, 19 U.S.C.A. § 58c.

[128] GATT Art. VIII:1(c): 'The contracting parties also recognize the need for minimizing the incidence and complexity of import and export formalities and for decreasing and simplifying import and export documentation requirements'.

[129] GATT Art. VIII:1(b): 'The contracting parties recognise the need for reducing the number and diversity of fees and charges referred to in subparagraph (*a*).'

[130] GATT Art. VIII:3: 'No contracting party shall impose substantial penalties for minor breaches of customs regulations or procedural requirements. In particular, no penalty in respect of any omission or mistake in customs documentation which is easily rectifiable and obviously made without fraudulent intent or gross negligence shall be greater than necessary to serve merely as a warning.'

[131] *EC—Bananas III* (Appellate Body), para. 204.

[132] According to *EC—Bananas III* (Appellate Body), para. 197 *et seq*. the requirements of Art. 1.3 concern the application and administration of the licensing rules rather than the rules as such; see also *EC—Poultry* (Panel), para. 254.

applications are not to be refused for minor documentation errors or for omissions or mistakes in documentation or procedures made without fraudulent intent or gross negligence (Article 1.7). Rules and all information concerning procedures for the submission of applications are to be published, whenever practicable, twenty-one days prior to the effective date of the requirement and never later than the effective date (Article 1.4 (a)).[133] Application forms, renewal forms, and procedures are to be simple (Articles 1.5 and 1.6). Applicant traders are to be allowed a reasonable period to submit licence applications.

The Agreement provides separate rules for 'automatic' (Article 2.1) and non-automatic (Article 3.1) licences. Automatic licensing procedures serve statistical purposes; as their potential for trade market access restrictions is somewhat limited, Article 2 provides only for very few disciplines. Non-automatic licences are regulated in a comprehensive fashion by Article 3 of the Agreement.

3.4 Agreement on Preshipment Inspection

Preshipment inspection of goods in international trade has become increasingly common as many governments supplement their port-of-unloading customs inspections by requiring importers to employ private inspectors to verify price, quality, and other characteristics of goods in the country of origin. This is done for several reasons, inter alia, to prevent over- or under-invoicing, misclassification, and under-collection of tariffs by stateside customs officials. As the frequency of preshipment inspections has increased, so have the claims that preshipment inspections (PSI) have become a significant non-tariff barrier.[134]

To minimize impediments to trade, the WTO Agreement on Preshipment Inspection (PSI Agreement) determines a minimum standard for all government-mandated preshipment inspection activities in its Article 1.1. Most importantly, pre-inspections are obliged to follow certain guidelines for price verification of goods: Price comparison may only be undertaken with 'the prices of identical or similar goods offered for export from the same country of exportation at or about the same time, under competitive and comparable conditions of sale, in conformity with customary commercial practices and not of any applicable standard discounts'.[135] In addition, WTO members must ensure that:

1. PSI activities are carried out in a non-discriminatory manner;
2. PSI inspections are performed in accordance with standards agreed between sellers and buyers or, in the absence of such standards, relevant international standards;
3. Conflicts of interest shall be avoided;
4. Confidential information shall be respected;

[133] In *EC—Poultry* (Panel), para. 246, the Panel rejected the view that frequent changes as such would be in violation of Art. 1.4.

[134] See generally Kenneth P. Kansa, 'A Cure Worse than the Disease' (1999) *Journal of International Law Association*, Vol. 39, 1152.

[135] PSI Agreement Art. 2.20(b).

5. PSI activities are to be carried out in a transparent manner; and
6. PSI activities are to be conducted without unreasonable delay.[136]

In the event of disputes between PSI operators and exporters, an amicable solution is to be sought.[137] Only if this proves unsuccessful, either party may refer the matter for review to the 'Independent Entity', administered by the WTO, which shall appoint a Panel of three experts to decide in a binding fashion the matter within eight working days.[138]

3.5 Agreement on Rules of Origin

Through their 'rules of origin' states determine the country of origin of goods.[139] Rules of origin are necessary to implement differential trade policies, such as applying higher tariff rates from developed countries than from least developed countries, applying low or zero tariff to imports from PTA partners, and, last but by no means least, applying trade remedy measures.

If all states were members of the WTO *and* had no preferential trade relationships in place, such rules would be largely superfluous. While the former is becoming increasingly the reality, the latter is increasingly not the case. In today's trade environment, much like in pre-GATT days, the origin of a product determines the tariff rate and other border measures: for example, if a can of tuna is deemed to originate in the least developed country A in whose EEZ tuna was caught, the applicable tariff may be very different from the tariff treatment attributed to the products originating in the developed country B where the canning factory is located.

Rules of origin have been a concern for both the GATT and other international agreements:[140] The GATT permits WTO members to maintain laws relating to marks of origin on imported products to protect consumers' pertinent interest to be properly informed.[141] Marks of origin may not, however, be discriminatory or unreasonably burdensome.[142] Country-of-origin marking requirements that single out foreign goods may be found to violate the GATT's national treatment provisions.[143] Also, the WCO-administered Revised Kyoto Convention provides extensive guidance on limiting the trade impediments caused by rules of origin requirements.[144]

[136] PSI Agreement Art. 3. [137] PSI Agreement Art. 4. [138] PSI Agreement Art. 4(e), (h).

[139] Art. 1:1 of the Agreement on Rules of Origin.

[140] See, for example, Joseph A. LaNasa III, 'Rules of Origin and the Uruguay Round's Effectiveness in Harmonizing and Regulating Them' (1996) *American Journal of International Law,* Vol. 90, 625, 626; Frederick P. Cantin and Andreas F. Lowenfeld, 'Rules of Origin, The Canada–U.S. FTA and the Honda Case' (1993) *American Journal of International Law,* Vol. 87, 375, 390.

[141] Nor are they allowed to work to the detriment of products with distinctive regional or geographic names, GATT Art. IX:6.

[142] GATT Art. IX, paras. 1 and 4.

[143] GATT Art. III:4. See also, for example, *Hawaii v Ho*, 41 Hawaii 565, 571 (1957) (invalidating state law requiring sellers of imported eggs to display a placard bearing the words 'we sell foreign eggs' as contrary to GATT Art. III:4). Origin marking is not, however, normally required for domestic products. Origin marking under GATT Art. IX is considered an exception to the national treatment obligations of Art. III. See John H. Jackson, *World Trade and the Law of the GATT* (Bobbs-Merrill Company, 1969), n. 11 at 461.

[144] International Convention on the Simplification and Harmonization of Customs Procedures (entered into force 3 February 2006 (hereinafter: B.I.S.D. Kyoto Convention)), Specific Annex K, published, inter alia,

The WTO Agreement on Rules of Origin (ROO), drafted with considerable input from the WCO, was entered into with the purpose of starting the process of harmonizing members' heterogeneous rules of origin.[145] The resulting rules of origin were supposed to be objective and coherent and must apply for all purposes.[146] They are to be determined by ongoing negotiations, which began in July 1995 and were supposed to end three years later.[147] Until harmonization has been achieved, WTO members are required to administer their current rules of origin pursuant to Article 2(a)–(k) of the Agreement on Rules of Origin. These provisions confirm, inter alia, the basic GATT principles of non-discrimination and transparency.[148] In particular, rules of origin may not be abused as instruments of trade policy or in a fashion disruptive to international trade;[149] they may not be more burdensome than those that apply to domestic products,[150] and must be based on positive standards.[151] As long as these general rules are being followed, the criteria determining origin may be quite diverse, reflecting the heterogeneous practice of members.[152] Three primary origin rules are used to determine the state of origin:

1. Did a tariff classification shift occur because of manufacturing operations?[153]
2. Did the manufacturing operations produce a 'substantial transformation' in the sense of a change of name, character, and use?[154]
3. Did the manufacturing operations meet a stated percentage of value added in terms of labour and materials in the preference state?[155]

All three tests may be combined into a single rule, and different tests may be used for different purposes.[156]

at <http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/conventions/pf_revised_kyoto_conv/ kyoto_new.aspx>.

[145] The WTO dispute settlement procedures apply to rule of origin disputes; cf. ROO Agreement Arts. 7–8. In the case of *US—Textiles Rules of Origin* (Panel), India challenged two US rule of origin requirements applicable to textiles and apparel under ss. 334 and 405 of the Uruguay Round Agreements Act, the 'yarn forward' and 'fibre forward' rules, which require a yard of fibre to be produced in the exporting country for that country to be considered the country of origin. The Panel found that India had not proven any inconsistency between the US rules of origin and the WTO Rule of Origin Agreement, cf. in particular para. 6.190 *et seq*. and para. 6.271 *et seq*.

[146] ROO Agreement Art. 1.2.

[147] The negotiating texts are contained in documents G/RO/45-series and document G/RO/W/111/ Rev.2. of 10 June 2008. Moreover, the latest report of the Committee on Rules of Origin concerning the Harmonisation negotiation, inter alia, states that 'at this meeting on 27 October 2011, the CRO agreed to the immediate initiation of the work to transpose the results of the Harmonization Work Programme to more recent versions of the HS nomenclature by the WTO Secretariat with a view to concluding that work as soon as possible'. See WTO document G/L/975 2 November 2011. See also Wim Keizer, 'Negotiations on Harmonized Non-Preferential Rules of Origin—A Useless Task from a Trade Policy Perspective?' (1997) *Journal of World Trade*, Vol. 31, 145–51.

[148] ROO Agreement Art. 2. Most of these rules apply only to non-preferential rules of origin relevant for intra-WTO relationships; however, see Annex II of ROO Agreement.

[149] ROO Agreement Art. 2(c).

[150] ROO Agreement Art. 2(d).

[151] ROO Agreement Art. 2(f).

[152] ROO Agreement Art. 2(a).

[153] This is the primary test used in the EU. See Ian S. Forrester, 'EEC Customs Law: Rules of Origin and Preferential Duty Treatment' (1980) *Eur. L. Rev*. 5, 167.

[154] See, for example, *SDI Technologies, Inc. v United States*, 977 F. Supp 1235 (Ct. Int'l Trade 1997).

[155] For example, *Torrington Co. v United States*, 764 F.2d 1563 (Fed. Cir. 1985).

[156] See Edwin A. Vermulst, Paul Waer, and Jacques Bourgeois, *Rules of Origin in International Trade: A Comparative Study* (University of Michigan Press, 1994).

3.6 Customs laws and procedures

The GATT contains few rules concerning customs laws and procedures. GATT Article X requires members to publish their trade-related laws, regulations, rulings,[157] and agreements in a prompt and accessible manner (Article X:1),[158] refrain from enforcing measures of general application prior to their publication (Article X:2), and administer the above-mentioned laws, regulations, rulings, and agreements in a uniform, impartial, and reasonable manner.[159] In this context, parties are required to institute or maintain tribunals or procedures for, inter alia, the prompt review and correction of administrative action relating to customs matters (Article X:3).[160] Numerous other GATT notification provisions further enhance transparency.[161]

Also, the Kyoto Convention contains annexes that harmonize procedures for operations such as the clearance of goods for home use,[162] outward processing[163] of goods (whereby goods are improved or assembled abroad), and inward processing[164] (whereby goods are admitted for in-country processing before being exported). Whereas the Kyoto Protocol is not an integral part of WTO law, most members are contracting parties of that treaty.

4. Non-Tariff Barriers II: Quantitative Restrictions

4.1 Introduction

Pursuant to Article XI:1:

> No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product

[157] cf. *EC—IT Products* (Panel), para. 7.1027; *US—Underwear* (Appellate Body), para. 29; *EC—Poultry* (Appellate Body), para. 113 *et seq.*

[158] cf. *Thailand—Cigarettes (Philippines)* (Panel), para. 7.819; *EC—IT Products* (Panel), para. 7.1015.

[159] cf. *Thailand—Cigarettes (Philippines)* (Panel), paras. 7.66–7.67; *US—Shrimp* (Appellate Body), para. 183.

[160] cf. *Argentina—Hides and Leather* (Panel), para. 11.71; *EC—Selected Customs Matters* (Appellate Body), para. 200.

[161] cf. GATT Art. XIII:3, Art. 2.11 of the TBT Agreement, Art. 12.6 of the Safeguards Agreement, and the Marrakesh Ministerial *Decision on Notification Procedures* which applies to both tariffs and non-tariff measures (cf. the Indicative List of Notifiable Measures in Annex 1), which lists 'Tariffs (including range and scope of bindings, GSP provisions, rates applied to members of free-trade areas/customs unions, other preferences); Tariff quotas and surcharges; Quantitative restrictions, including voluntary export restraints and orderly marketing arrangements affecting imports; Other non-tariff measures such as licensing and mixing requirements; variable levies; Customs valuation; Rules of origin; Government procurement; Technical barriers; Safeguard actions; Anti-dumping actions; Countervailing actions; Export taxes; Export subsidies, tax exemptions and concessionary export financing; Free-trade zones, including in-bond manufacturing; Export restrictions, including voluntary export restraints and orderly marketing arrangements; Other government assistance, including subsidies, tax exemptions; Role of state-trading enterprises; Foreign exchange controls related to imports and exports; Government-mandated countertrade; Any other measure covered by the Multilateral Trade Agreements in Annex 1A to the WTO Agreement'.

[162] Kyoto Convention, n. 144 at Annex B.1.

[163] Ibid. Annex E.8. [164] Ibid. Annex E.6.

of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

GATT Article XI prohibits quantitative restrictions on exports and imports, regardless of whether they are implemented through quotas, import and export licences, and any other measures that prohibit or restrict trade other than duties, taxes, and other charges.[165] Thus, Article XI curtails the sovereign right of states to take measures at the border in order to influence, limit, or block trade flows crossing the border; it does not address so called *internal measures*, that is, state measures that apply to products *after* they have legally entered the market.[166] Since 1995, members have been obliged to notify the Council of all quantitative restrictions in force, including all modifications,[167] as soon as possible, but not later than six months after the provision's entry into force.[168]

In contrast, Article III deals with measures *affecting* legally imported products. The difference may be normally clear and obvious. However, the picture becomes blurred when internal (tax) measures are enforced at the border, or when (for example, as a consequence of efforts to facilitate the flow of merchandise at the border) border measures are enforced only once the product has reached its final destination. The former example is taken care of by the *Ad* note to Article III: it states that an internal measure stays an internal measure, even if it is 'enforced or collected in the case of an imported product at the time or point of importation'.

Whether Article III or Article XI applies can be crucial: GATT Article III (impliedly) *permits* internal measures that are non-discriminatory (as between domestic and imported products), whereas Article XI:1 *prohibits* quotas, import and export licences, and any other measures that restrain trade other than duties, taxes, and other charges.[169] It is, for example, permissible to enforce a size limitation on imported lobsters equal to that imposed on domestically caught lobsters. Size is an internal regulation even though it is enforced on importation.[170] It may, however, not be GATT-compatible to ban imported tuna because of the dolphin-unfriendly way it was harvested.[171]

[165] *India—Quantitative Restrictions* (Panel), paras. 5.122–5.144.

[166] GATT Panel report, *Canada—Administration of the Foreign Investment Review Act*, L/5504, adopted 7 February 1984, B.I.S.D. 30S/140. See also *Lobsters from Canada*, USA-89–1807–01 (U.S.-Canada FTA Ch. 18 decision), 3 Can. Trade & Commodity Tax Cas (CCH) 8182 (1990).

[167] Decisions by the Council for Trade in Goods, WTO Doc. G/L/59 (10 January 1996), *Decision on Notification Procedures for Quantitative Restrictions*, adopted on 1 December 1995; replaced by WTO Doc. G/L/59 Rev. 1 (3 July 2012), *Decision on Notification Procedures for Quantitative Restrictions*, adopted on 27 June 2012.

[168] Ibid. para. 2.

[169] *China—Raw Materials* (Panel), paras. 7.918–7.921; *US—Poultry (China)*, paras. 7.442–7.457; *Japan—Trade in Semi-Conductors*, para. 104.

[170] See *Lobsters from Canada*, n. 166.

[171] GATT Panel report, *United States—Restrictions on Imports of Tuna*, DS21/R, 3 September 1991, unadopted, B.I.S.D. 39S/155, paras. 5.17–5.18; cf. also GATT Panel report, *Canada—Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, DS17/R, adopted 18 February 1992, B.I.S.D. 39S/27 (holding that package size limits for beer are subject to GATT Art. III:4); *EC—Asbestos* (Panel), paras. 8.83–8.100 (Panel found that because the measure applies to *both* the imported product *and* the like domestic product, it falls within the terms of the *Ad* note to Art. III and is therefore subject to Art. III:4; as a result, considered it unnecessary to determine whether Art. XI:1 applies as well).

4.2 Prohibition on quantitative restrictions: a primer

GATT Article XI prohibits, in principle,[172] all quantitative restrictions.

(1) The first type of quantitative restrictions mentioned are *prohibitions of importation or exportation*. Prohibitions refer to a total ban on export or import, whereas the 'restrictions' mentioned in the remainder of Article XI:1 render export or import more difficult without making it impossible. An example of a prohibition would be national laws banning imports of alcoholic beverages for religious reasons, or banning the importation of environmentally unsustainably harvested wood for environmental reasons.[173]

(2) Of more practical relevance are all other quantitative restrictions.

   (a) *Quotas* are numerical restrictions on imports or exports.[174] An example would be an annual quota of twenty mio. Christmas trees per year. Once twenty million trees have been imported in a given year, any further tree (as pretty as it may be) will be barred from entering the customs territory of a member. Quotas are usually expressed in terms of units of products allowable per year, rather than in terms of value. Note, that so-called *tariff quotas are not* quantitative restrictions for the purposes of Article XI. Rather, they determine the volume of imported (or exported) goods that benefit from a given customs rate. Once the predetermined volume is exceeded, the products are imposed with a higher customs duty.[175] Tariff quotas are common for agricultural products:[176] for example, in the *Bananas III* case, the EU applied a three-tiered tariff quota for bananas.[177] Import quotas are effective trade barriers, as they limit the supply of competitively well-positioned imported goods, thereby allowing more sales of domestic goods. As a consequence, consumers have to pay higher prices.

   (b) GATT Article XI:1 covers not only quotas, but broadly covers *all* 'other measures that restrict imports'[178] without distinguishing between de jure and de facto restrictions.[179] 'Other measures' can refer to virtually any requirement or regulation designed to inhibit imports or exports. Thus,

[172] But see the many exceptions, for example, GATT Art. XIII.

[173] *US—Shrimp* (Panel), para. 7.17.

[174] It is important to note that the quotas are different from the tariff-rate quotas (TRQs). Tariff-rate quotas or tariff quotas are predetermined quantities of goods which can be imported at a preferential rate of customs duty. After the completion of tariff-rate quota, a higher tariff rate is applied to further unlimited importation. Meanwhile, GATT Art. XIII:5 has disciplined the allocation of the tariff-rate quotas.

[175] cf. *US—Line Pipe* (Panel), para. 7.18.

[176] GATT Panel report, *Japan—Restrictions on Imports of Certain Agricultural Products*, L/6253, adopted 2 March 1988, B.I.S.D. 35S/163.

[177] See *EC—Bananas III* (Panel), para. 3.7.

[178] Rather, they apply 'to all measures instituted or maintained by a contracting party prohibiting or restricting the importation, exportation or sale for exports of products other than measures that take the form of duties, taxes or other charges'; *Japan—Semiconductors* (GATT 1947 Panel), B.I.S.D. 35S/116, para. 104; see also *India—Auto* (Panel), paras. 7.225–7.281 and 7.318–7.322.

[179] *Argentina—Hides and Leather* (Panel), para. 11.17; see also *China—Raw Materials* (Panel), para. 7.172; *Colombia—Ports of Entry* (Panel), para. 7.251; *US—Poultry* (China) (Panel), para. 8.20.

> export quotas,[180] data collection and monitoring requirements,[181] discretionary non-automatic licensing systems,[182] minimum price systems,[183] prohibiting importation of copyrighted works not manufactured domestically,[184] requiring security deposits,[185] prohibiting imports not produced in a certain way,[186] trade balancing requirements,[187] and restrictions on ports of entry[188] may all be incompatible with Article XI:1.

Article XI:1 applies to quotas and other measures regardless of the way they are enforced or rendered operational: it does not matter whether the restrictions in question are enforced in the 'traditional way', that is, through customs regulation,[189] or if they are implemented, for example, by state-trading companies or import monopolies.[190] Article XI:1 even addresses measures that are not legally enforceable, provided they meet two criteria: (1) there are reasonable grounds to believe that sufficient incentives or disincentives existed for the non-mandatory measures to take effect; and (2) the operation of the measures is essentially dependent on government action.[191] In a dispute, the complaining party need not show that the operation of the allegedly Article XI-incompatible measures has had a measurable effect on trade. Rather, Article XI:1 has been interpreted to protect *conditions of competition*; a quota or other measure will be illegal regardless of whether an actual effect on trade can be shown.[192] Therefore, a complaining party does not need to convince a Panel that a quota had a trade restrictive effect: a quota is *as such* incompatible with GATT Article XI, regardless of the effect, as it is a clear and manifest deviation from the promise of market access. With regard to other quantitative restrictions, complainants would be well advised to show some trade effect in order to convince a Panel that they have indeed created an indirect disincentive to import:[193]

> In the present case, we note that the fines as a whole, including that on marketing, *have the effect of penalizing* the act of 'importing' retreaded tyres by subjecting retreaded tyres already imported and existing in the Brazilian internal market to the prohibitively expensive rate of fines. To that extent, we consider that the fact that the fines are not administered at the border does not alter their nature as a restriction on importation within the meaning of Article XI:1.[194]

[180] *China—Raw Materials* (Panel), paras. 7.172–7.175.
[181] *Japan—Trade in Semi-Conductors*, B.I.S.D. 35S/116.
[182] *India—Quantitative restrictions* (Panel), para. 5.122; *China—Raw Materials* (Panel), para. 7.918.
[183] *EEC—Minimum Import Prices*, B.I.S.D. 25S/68, para. 4.14 would be an example of minimum import price systems, whereas *China—Raw Materials* provides an example for minimum export price systems.
[184] *US—Manufacturing Clause*, B.I.S.D. 31S/74, para. 34.
[185] *EEC—Minimum Import Prices,* B.I.S.D. 25S/68, para. 4.14.
[186] *US—Shrimp* (Panel), para. 7.17.
[187] *India—Autos* (Panel), para. 5.233.
[188] *Colombia—Ports of Entry* (Panel), para. 7.275.
[189] *Canada—Periodicals* (Panel), paras. 5.4–5.5.
[190] For example, *Canada—Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, 22 March 1988, GATT B.I.S.D. 35S/37 (1989).
[191] See *Japan—Trade in Semi-Conductors*, paras. 104–7.
[192] GATT Panel report, *European Economic Community—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, L/6627, adopted 25 January 1990, B.I.S.D. 37S/86.
[193] *India—Autos* (Panel), para. 7.269.
[194] *Brazil—Retreaded Tyres* (Panel), para. 7.372 (emphasis added). In the same sense, before that, *Dominican Republic—Import and Sale of Cigarettes* (Panel), para. 7.261: 'Not every measure affecting the

To a certain extent, this line of jurisprudence does away with the distinction between internal and border measures with regard to internal state measures that create a strong disincentive to undertake the not insignificant risks of market access.[195]

4.3 Exceptions to the prohibition on quotas and other measures

Article XI:2 provides exceptions to the general prohibition contained in paragraph 1: The first exception, GATT Article XI:2(a), permits WTO members to prohibit or restrict exports of foodstuffs or other similarly essential products, provided that the restrictions are applied temporarily with the objective of preventing or relieving critical shortages of that product.[196] The second exception, GATT Article XI:2(b), permits WTO members to apply '[i]mport or export prohibitions or restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade'.[197] The third exception permits WTO members to apply '[i]mport restrictions on any agricultural or fisheries product . . . necessary to the enforcement of governmental measures' that (1) restrict the marketing or production of the 'like' domestic product (or a directly substitutable product if there is no substantial production of the like product); (2) remove a temporary surplus of a like domestic product (or a directly substitutable product if there is no substantial production of the like product) by making the surplus available to certain groups of domestic consumers free of charge or at prices below the current market level; or (3) restrict production of any animal product that is directly dependent on the imported commodity, if the domestic production of that commodity is relatively negligible. Unlike the previous two exceptions, GATT Article XI:2(c) does not permit the prohibition of imports but only their restriction, upon public notification of the total quantity restricted.[198] At the time of writing, governmental measures have never been justified under any of these exceptions.[199]

opportunities for entering the market would be covered by Article XI, but only those measures that constitute a prohibition or restriction on the importation of products, i.e. those measures *which affect the opportunities for importation itself*' (emphasis added).

[195] Compare this with the state of play in the EU, where '[a]ll trading rules enacted by member states which are capable of hindering, directly or indirectly, actually or potentially, intra-community trade are to be considered as measures having an effect equivalent to quantitative restrictions', pursuant to the constant jurisprudence of the CJEU (Case 8/74, *Procureur du Roi v Benoit and Gustave Dassonville* [1974] E.C.R. 837, para. 5). This includes regulations on marketing (but see Joined Cases C-267 and 268/91, *Criminal proceedings against Bernard Keck and Daniel Mithouard* [1993] E.C.R. I-6097), packaging, and not just border measures.

[196] GATT Art. XI:2(a); see also *China—Raw Materials* (Panel), paras. 7.238–7.353.

[197] GATT Panel report, *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, L/6268, adopted 22 March 1988, B.I.S.D. 35S/98, para. 4.2 (restrictions on export not justified by GATT Art. XI:2(b)).

[198] WTO members restricting imports of products necessary to the enforcement of a domestic marketing or production restriction must ensure that the import restriction does not reduce the proportion of imports relative to the total of domestic production, GATT Art. XI:2, last subpara.

[199] GATT Panel report, *Canada—Import Restrictions on Ice Cream and Yoghurt*, L/6568, adopted 5 December 1989, B.I.S.D. 36S/68, para. 84 (concluding that Canada's import restrictions on ice cream and yoghurt were inconsistent with Art. XI:1 and could not be justified under Art. XI:2(c)(i) because ice cream and yoghurt are not 'like' products to Canadian raw milk and the import restriction on ice cream and yoghurt is not necessary to the enforcement of the Canadian programme for raw milk); GATT Panel report, *Japan—Restrictions on Imports of Certain Agricultural Products*, L/6253, n. 176, paras. 6.2–6.8, at

In addition to the above-mentioned specific exceptions, deviations from Article XI may be based on GATT Article XII, which allows restrictions to safeguard balance of payments. Of course, Article XX (General Exceptions), Article XXI (Security Exceptions), and the Escape Clause (GATT Article XIX) must be considered as justification for possible non-conforming measures; they are discussed later. In the past, important exceptions were granted through waivers[200] under GATT Article XXV.[201]

5. Non-Tariff Barriers III: Other Measures Restricting Market Access

5.1 State-trading enterprises

State-trading enterprises pose what is sometimes called an 'interface' problem in international trade. This refers to the fact that the GATT somewhat presupposes the market as a determining force. State trading therefore may 'create serious obstacles to trade'.[202] For example, a state monopoly can discriminate between different country markets, adopt artificial prices that are substitutes for tariffs, adopt quotas for imports or exports, and ensure more favourable treatment for domestic products by adopting whatever regulations it wants for the distribution and sale of imports. In this way state trading may subvert normal trade concessions in the form of tariff reductions.

To deal with these problems, the GATT addresses state-trading enterprises in several provisions, mainly in Article XVII. Although state trading is primarily associated with 'non-market economy' states, Article XVII defines state-trading enterprises in broader terms to include any enterprise that benefits, whether formally or de facto, from 'exclusive or special privileges'. This definition includes not only state-owned enterprises as such, but also import or export monopolies and marketing boards; these institutions are very common in many Western states, including Canada, France, or the Nordic countries. Article XVII would therefore appear to reach, in non-market economy states, private companies under state-planning controls as well as state-owned or state-benefited companies in market economy states.[203]

243–5 (holding that Japan's import restrictions on agricultural products violate GATT Art. XI:1). See also GATT Panel report, *European Economic Community—Restrictions on Imports of Dessert Apples—Complaint by Chile*, L/6491, adopted 22 June 1989, B.I.S.D. 36S/93; GATT Panel report, *European Economic Community—Restrictions on Imports of Apples—Complaint by the United States*, L/6513, adopted 22 June 1989, B.I.S.D. 36S/135.

[200] For example, Waiver Granted to the United States in Connection with Import Restrictions Imposed Under Section 22 of the Agricultural Adjustment Act (of 1933), as Amended, 5 March 1955, GATT B.I.S.D. 3S/32 (1955).

[201] There now are additional restrictions on waivers: see Chapter 1. Moreover, the regulations concerning the administration of quantitative restrictions (which is an exception to Art. XI) is contained in GATT Art. XIII. They provide that when quantitative restrictions are authorized under the relevant provisions of the GATT, they must be imposed on a non-discriminatory basis.

[202] This possibility is explicitly recognized in GATT Art. XVII:3.

[203] An important exclusion is enterprises that buy goods for immediate or ultimate consumption in governmental use. GATT Art. XVII:2.

In 1999, the WTO developed its *Illustrative List of Relationships between Governments and State Trading Enterprises*[204] that broadly defines state-trading company activities subject to GATT Article XVII. Such enterprises may be governmental or non-governmental entities; granted exclusive or special rights or privileges; and which influence through purchases or sales the level or direction of exports and imports.

All enterprises covered by Article XVII have a duty of transparency. Article XVII:4 and the 1994 Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994[205] require notification of state-trading enterprises. Notification must include a discussion of their need, practices, and operations. The level of notification must 'ensure the maximum transparency possible'.[206] Notifications and counter-notifications must be reviewed by the WTO Council for Trade in Goods,[207] which has the power to make recommendations on the 'adequacy of notifications and the need for further information'.[208]

State-trading enterprises must abide by three overriding substantive norms: (1) in purchases or sales involving imports or exports, they must 'act in a manner consistent with the general principles of non-discriminatory treatment prescribed in [the GATT] for governmental measures affecting imports or exports by private traders';[209] (2) they must make such purchases or sales 'solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale';[210] and (3) they must 'afford the [other] enterprises . . . adequate opportunity, in accordance with customary business practice, to compete for . . . such purchases or sales'.[211]

In *Canadian Wheat Board* (2004),[212] the Appellate Body addressed the relationship between subparagraph (a) of Article XVII:1 (which requires state-trading enterprises to 'act in a manner consistent with . . . the general principles of non-discriminatory treatment' prescribed in the GATT) and subparagraph (b) of the same Article (which requires state trading enterprises to 'make . . . purchases and sales solely in accordance with commercial considerations' and to 'afford the enterprises of other [WTO] Members adequate opportunity . . . to compete . . . in such purchases or sales'). According to the Appellate Body, subparagraph (a) sets out a general obligation of non-discrimination,[213] while subparagraph (b) defines the precise scope of that obligation.[214] The term 'enterprises' in subparagraph (b) was interpreted to mean 'enterprises interested in buying the products offered for sale by an export state

[204] See WTO Doc. G/STR/4, Working Party on State Trading Enterprises, Illustrative List of Relationships between Governments and State Trading Enterprises and the Kinds of Activities engaged in by these Enterprises, adopted by Council in October 1999, WTO Doc. G/C/M/41, para. 3.1.

[205] cf. Tania Voon, 'Understanding on the Interpretation of Article XVIII GATT 1994' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Holger P. Hestermeyer, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Goods*, Vol. 5 (Leiden: Martinus Nijhoff Publishers, 2011).

[206] Ibid. para. 2. [207] Ibid. para. 5. [208] Ibid.

[209] GATT Art. XVII:1(a); see also *Canada—Wheat Exports and Grain Imports* (Appellate Body), para. 85.

[210] GATT Art. XVII:1(b). [211] Ibid.

[212] *Canada—Wheat Exports and Grain Imports* (Appellate Body).

[213] *Korea—Various Measures on Beef* (Panel), para. 769.

[214] *Canada—Wheat Exports and Grain Imports* (Appellate Body), para. 100.

trading company', not enterprises selling the same product in competition with the state trading company.[215] Thus, the Appellate Body rejected the United States' claim that subparagraph (b) of Article XVII:I had to be read separately and interpreted in a way so as to allow competition with the state trading enterprise in question.

The effect of the WTO system is to accept the existence of state-trading enterprises but to compel them to act 'as if' they were subject to the same market influences as private actors and adhere to the same practices that private companies would show. It may be questioned whether it is a realistic expectation that such a policy may be transposed adequately. Before 2001, this policy was never seriously tested or challenged, because the larger non-market economy states were not parties to the agreement and because of the general economic movement toward the privatization of enterprises.

The norms applicable to state-trading enterprises should be examined closely in the following areas. First, in the area of tariffs, it is clear that schedules of concession are intended to cover products in which state-trading enterprises are involved. The GATT addresses this explicitly by stating that authorized import monopolies (for example, state-trading enterprises) 'must not afford protection on the average in excess of the amount of protection provided in [the] Schedule'.[216] In addition, the GATT provides that import monopolies dealing in products that are *not* the subject of Article II concessions must disclose their import mark-up.[217]

Secondly, state-trading enterprises must, pursuant to GATT Article XVII:1 lit. (a), 'act in a manner consistent with the general principles of non-discriminatory treatment prescribed in [the GATT] for governmental measures affecting imports or exports by private traders'. This includes at least the most favoured nation (MFN) obligation of GATT Article I.[218] However, the national treatment (NT) clause is the second major manifestation of the non-discrimination principle, and thus the Panel in *Korea—Beef* rightly assumed that the national treatment obligation is referred to in Article XVII:1 lit. (a).[219]

Thirdly, state-trading enterprises are subject to the prohibition on 'quotas, import or export licenses or other measures' in GATT Article XI:1. In the 1988 Panel report *Japan—Restrictions on Imports of Certain Agricultural Products*,[220] the Panel concluded that Article XI:1 applied to import restrictions made effective through an

[215] Ibid. para. 161.
[216] GATT Art. II:4. [217] GATT Art. XVII:4(b).
[218] *Canada—Wheat Exports and Grain Imports* (Panel), para. 6.48.
[219] *Korea—Various Measures on Beef* (Panel), paras. 15 and 753; this is in line with the opinion of various pre-WTO GATT Panels, for example *Canada—Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, DS17/R, adopted 18 February 1992, B.I.S.D. 39S/27, paras. 5.10–5.16; GATT Panel report, *Canada—Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, L/6304, adopted 22 March 1988, B.I.S.D. 35S/37, para. 4.26. See, however, the opposite opinion expressed by a GATT Panel, according to whom there is 'force' in the argument that 'only the most-favoured-nation and not the national treatment obligations fall within the scope of the general principles referred to in Article XVII:1(a)'; GATT Panel report, *Canada—Administration of the Foreign Investment Review Act*, L/5504, adopted 7 February 1984, B.I.S.D. 30S/140, paras. 5.15–5.18, at 163–4.
[220] *Japan—Restrictions on Imports of Certain Agricultural Products*, n. 176 at paras. 5.2.2.1–5.2.2.2.

import monopoly because it is comprehensive and because the *ad* notes to Articles XI, XII, XIII, XIV, and XVIII provide that the terms 'import restrictions' and 'export restrictions' used in these Articles include restrictions made effective through state-trading enterprises. This is now confirmed by WTO jurisprudence.[221]

Finally, there is no special treatment or derogation granted to state-trading enterprises with respect to subsidies or dumping norms,[222] although practical problems of implementation of antidumping norms may occur if market forces do not determine prices.[223]

5.2 Technical barriers to trade

The WTO Agreement on Technical Barriers to Trade (TBT Agreement), discussed in detail below, seeks to strike a balance between protecting members' freedom to define product standards and minimizing their negative trade effects. According to its preamble, the TBT Agreement intends to ensure that technical regulations, standards, and conformity assessment procedures do not constitute unnecessary barriers to international trade. It recognizes 'that no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices, at the levels it considers appropriate'. Members may protect these and other legitimate objectives while abiding by the disciplines prescribed by the TBT Agreement. These measures shall not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade.

5.3 Sanitary and phytosanitary measures

Health and safety measures, so-called sanitary and phytosanitary measures (SPS measures) may also constitute barriers to trade. The Agreement on Sanitary and Phytosanitary Measures (SPS Agreement) recognizes the right of governments to take measures to protect human, animal, and plant life or health, as long as these are based on science, are necessary for the protection of health, and do not unjustifiably discriminate among foreign sources of supply. It was negotiated as part of the Agreement on Agriculture and is now a sister agreement to the TBT Agreement.

[221] *India—Quantitative Restrictions* (Panel), para. 5.134; *Korea—Various Measures on Beef* (Panel), para. 748.

[222] These are contained generally in GATT 1994 Art. VI and in the subsidies and antidumping agreements. See generally Chapters 12 and 13.

[223] In conclusion, it must be noted that the Working Group on State Trading Enterprises has been inactive since the adoption of its draft report on 4 November 2003 (G/STR/W/41).

5.4 Sectoral market access agreements

Since the very beginning of the multilateral trading system, certain product categories have been de facto[224] or de jure[225] exempted from the regular disciplines of market access: that has certainly been the case for agricultural products and for textiles. In the history of the GATT, certain economic sectors received special treatment due to special problems or political sensitivity. To a significant extent that de-linkage between these two product categories and the normal disciplines for trade in goods has ended due to the Marrakesh Agreement Establishing the WTO.

5.4.1 Textiles and clothing

From 1974 to 1994/2004, the Multifibre Arrangement (MFA) allowed the contracting parties of the GATT to enter into bilateral trade restrictive arrangements with regard to textiles and clothing, which would otherwise not have been compatible with either GATT Article XI or XXIV. The MFA allowed states to impose high quotas on imported clothing and textiles.[226] This untenable situation was addressed by the WTO Agreement on Textiles and Clothing (ATC), which provided for the gradual reintegration of textiles and clothing into the normal GATT/WTO regime: By 2004, all quotas had been abolished, in line with ATC Article 9; however, tariffs may be bound at relatively high levels.[227]

During the ten-year transitional period, the Appellate Body decided in three cases that quotas and other import restrictions on textiles and clothing were illegal.[228] In addition, two DSB decisions ruled that the imposition of a transitional safeguard measure was improper under ATC Article 6.[229]

Since the expiration of the ATC, international trade in textiles and clothing has gone through fundamental changes. The integration of this sector into GATT 1994 impacted not only the textile industry in importing countries, but also the export industries of dozens of countries as exports diverted to those producers with a competitive advantage in world markets. In a comprehensive study of textile and clothing trade,[230] the

224 That is particularly the case for agricultural products, with the exception of the United States who obtained a waiver in 1955; cf. Waiver Granted to the United States in Connection with Import Restrictions Imposed Under Section 22 of the Agricultural Adjustment Act (of 1933), as Amended, 5 March 1955, B.I.S.D. 3S/32 (1955).

225 For example, the US agricultural waiver and the disciplines of the Multifibre Agreement.

226 See GATT Secretariat, *Textiles and Clothing in the World Economy* (1984).

227 See Robert C. Cassidy and Stuart M. Weiser, 'Uruguay Round Textiles and Apparel' in Terence P. Stewart, ed., *The World Trade Organization* (Chicago, IL: American Bar Association, 1996) 223.

228 *Turkey—Textiles* (Appellate Body) (Turkey's imposition of import quotas was a violation of ATC Art. 2.4 as well as GATT Art. XI and was not justified by GATT Art. XXIV); *India—Quantitative Restrictions* (India's import quotas were not justified as balance-of-payments restrictions); *Argentina—Textiles and Apparel* (Appellate Body) (Argentina's 'statistical tax' on imports violated GATT Arts. II and VIII and was not justified by the Agreement between the IMF and the WTO).

229 In *US—Underwear* (Appellate Body), the backdating of the imposition of a safeguard measure was found to violate ATC Art. 6.10; in *US—Wool Shirts and Blouses* (Appellate Body), transitional safeguard measure were found to violate ATC Arts. 2 and 6.

230 The Global Textile and Clothing Industry Post the Agreement on Textiles and Clothing, World Trade Organization, 2004, available at <http://www.wto.org>.

WTO predicted that China and India would dominate world production of textile and clothing in the immediate aftermath of the ATC. This is indeed what has happened, much to the disadvantage of smaller developing countries in Latin America and Africa. In an attempt to pre-empt strong political opposition in its export destinations, China introduced export duties on numerous textile products, in addition to strict limitations contained in its Protocol of Accession.

5.4.2 Agriculture

Agriculture, the topic of the next chapter, is a sensitive topic in virtually every country. The reasons for this are manifold. Apart from the obvious importance of food for survival, the agricultural sector is politically well connected in almost every WTO member: this means that farm policies in almost every country of the world have a sustained leaning towards protectionist measures. That is true even for major agricultural exporters who have a tendency to clamp down massively on imports of processed agricultural products like cheeses, hams, sausages, and the like.

With the AoA, the WTO members agreed to abolish quantitative restrictions. As will be discussed in the following chapter, the tariffication mandated by the AoA has sometimes led to very significant tariffs.

9

Agricultural Trade

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1. Introduction

Agricultural products, in particular food, have an existential, political, and strategic relevance that transcends their economic importance. This is clearly true for a number of goods, such as cultural products or so called dual-use products that serve both a civilian and a military purpose. Food, however, is an *immediate* necessity for survival (as is water). Whereas malnourishment is still a reality in many states, the fear of food scarcity is deeply engrained in the collective psyche of even the most affluent states, as the experience of famine is never further away than a hundred years, very often much less than that.

Somewhat in contrast to that experience, the Agreement on Agriculture[1] has been negotiated after a thirty-year period of food surplus. In this environment, the agricultural producers of the Southern hemisphere (and Canada) had an interest in the Northern hemisphere developed countries—such as the countries of the EU, Japan, Norway, Switzerland, but also the United States—agreeing to restrict the subsidization of their agricultural industries and facilitate market access to these important markets. The heavily subsidized surplus Northern produce had been erasing the competitive advantages of Southern producers, thereby eliminating the chances of efficient producers to reap the fruits of their enterprise. This period of agricultural surplus production proper may have gone forever: since the conclusion of the Uruguay Round farmers have become important feeder industries for fossil-oil substitutes; climate change has stopped being just a topic of discussions in tertiary institutions, and has already caused dramatic changes in how import-dependent countries such as Japan and China are trying to ensure their long-term supply of foodstuffs. The food crisis of 2007–08, often forgotten due to the ensuing global financial crisis (GFC), put more than a dent in the developing countries' confidence in the invisible hand of agricultural markets: Many Asian countries experienced severe food supply difficulties. As a consequence, the topic of food security has become a hot topic in both the Doha Development Agenda (DDA) and academic discussions.

The difficulty in establishing sound rules for agricultural trade is linked not least to the strong influence agricultural producers tend to have on political decision-makers: In many *developing countries*, agriculture may currently be the only industry capable of generating export products that will meet world market demand; in this environment, the political attention paid to agricultural production (and producers) comes as no surprise. However, despite the often very limited contribution to the GDP of *developed countries*, much the same is true there. Although the agricultural sector's economic relevance has significantly diminished in the last 100 years, OECD members' subsidies still *surpass* those of the emerging countries by almost US$40 billion: in 2012, OECD members supported its agricultural industries with the staggering sum of US$259 billion.[2] Typically, the political systems of Western democracies are geared to favour rural areas which tend to be overrepresented in all parliaments. In the United States, presidential nominations start with a straw poll in corn-rich Iowa.

The Uruguay Round Agreement on Agriculture (AoA) introduces itself to the reader as a work-in-progress, as part of a 'reform process'.[3] Negotiators did not view it as an outcome that was supposed to stay unaltered for some time.[4] Also, it is far from being

[1] For an overview cf. Joseph A. McMahon and Melaku Geboye Desta, eds., *Research Handbook on the WTO Agriculture Agreement: New and Emerging Issues in International Agricultural Trade* (Edward Elgar, 2012).

[2] *Agricultural Policy Monitoring and Evaluation 2013, OECD Countries and Emerging Economies* (OECD 2013) 15 *et seq.*; in emerging economies such as the BRICS, agricultural subsidies surpassed US $210 billion in 2012; see Stefan Tangermann, 'Post-Bali Issues in Agricultural Trade: a Synthesis', Background Document for the OECD Global Forum on Agriculture (OECD: Paris 2014), at 10.

[3] AoA, Preamble, para. 1.

[4] Bernhard O'Connor, 'A Note on the Need for More Clarity in the World Trade Organization Agreement on Agriculture' (2003) *Journal of World Trade* 37, 839, 845; Fiona Smith, *Agriculture and the WTO: Towards a New Theory of International Trade Regulations* (Edward Elgar, 2009) 97, 98.

the *exclusive* source of WTO rules on agricultural products. As WTO law stands, trade in agricultural products is subject to pertinent provisions of most WTO agreements, in particular those found in the Agreement on Subsidies and Countervailing Measures (SCM Agreement), the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement), and the GATT itself. However, the AoA will be at the centre of attention in this chapter, whereas the other provisions will be dealt with elsewhere in this book; this notwithstanding, the relationship between the AoA and the SCM Agreement will be examined here.

2. Historical Context

The AoA is the result of the Uruguay Round and was concluded in 1994.[5] A new student of WTO law may wonder why a special agreement for agricultural products was even necessary.[6] After all, agricultural products are goods, and goods are taken care of by the GATT (and its many side agreements). Indeed, it was consensus in pre-WTO days that the GATT, pursuant to its unequivocal wording (which covers goods without excluding the agricultural sector) regulated, in theory, both industrial *and* agricultural goods. An even greater consensus, existed, however, as to the almost complete de facto exemption of agriculture from GATT disciplines.

The reasons for this phenomenon are manifold, complex, and highly interesting. For the sake of brevity, this chapter limits itself to a most sketchy and superficial overview:[7] The first (and possibly least relevant) reason for the de facto non-application of the GATT to agricultural products lies in the existence of multiple exceptions for agricultural products in the GATT. For example, GATT Article XI:2(a) to (c) exempts agricultural products from the prohibition of quantitative restrictions, if they are necessary to support government programmes destined to control the production or marketing of a domestic product or to prevent shortages of foodstuffs.[8] Similarly, GATT Article XVI prohibits export subsidies, but contains an exception for primary products.[9]

Despite this special regime for agriculture, GATT rules were perceived as being too onerous by some of the Northern agricultural producers: From the early days of the GATT onwards, the United States maintained a series of measures restricting imports of certain agricultural products.[10] Whereas a Panel sided with the Netherlands that the US restrictions (in the case at hand: on imports of milk) were in violation of GATT

[5] cf. Joseph A. McMahon and Melaku Geboye Desta, eds., *Research Handbook on the WTO Agriculture Agreement: New and Emerging Issues in International Agricultural Trade* (Edward Elgar, 2012) 1–33.

[6] cf. Fabian Delcros, 'The Legal Status of Agriculture in the World Trade Organization' (2002) *Journal of World Trade* 36, 219–53.

[7] cf. the historic overview in Michael Trebilcock, Robert Howse, and Antonia Eliason, *The Regulation of International Trade*, 4th edn. (Routledge, 2013) 435–50.

[8] But cf. GATT Art. XIII.

[9] GATT jurisprudence has not always been consistent. See on the one hand, the GATT Panel report, *French Assistance to Exports of Wheat and Wheat Flour*, L/924, adopted 21 November 1958, B.I.S.D. 7S/46 and, on the other hand, GATT Panel report, *European Economic Community—Subsidies on Export of Wheat Flour*, SCM/42, 21 March 1983, unadopted, available at <http://www.worldtradelaw.net/document.php?id=reports/gattpanels/eecwheatflour.pdf>.

[10] John H. Jackson, *The World Trading System*, 2nd edn. (MIT Press, 1997) 413.

Article XI:2,[11] the US Congress mandated a continuation (and even expansion) of these measures.[12] Many contracting parties saw the possibility that the United States would have terminated the GATT, if that ruling had been properly enforced. In order to avoid that highly undesirable scenario, the GATT contracting parties legalized the illegal US measures by granting a waiver pursuant to GATT Article XXV, allowing the global hegemon to maintain its restrictions on agricultural trade.[13] Not surprisingly, this did not help to motivate the other GATT partners to abide by the rules with regard to their agricultural products. In the same vein, it did not encourage the usually quite litigious United States to move against the agricultural policies of its partners: The EEC's Common Agricultural Policy (CAP) was thus attacked only late in the game.

The third reason for the reluctance of states to subject agricultural trade to the rules of free trade is the historical proximity to real and painful food shortages. After the experiences of the Great Depression and two World Wars, most governments were keen to strengthen their agricultural sectors so as to allow independence from foreign supplies. For instance, Switzerland's self-sufficiency policy after the First World War had served the country well during the Second World War and the immediate post-war period. In this context, prevention of rural depopulation at a time when the metropolitan areas became ever more attractive was another contributing factor. The (then EEC's) CAP was an important part of the fundament of European post-Second World War integration: The experience of hunger had been particularly stark in Europe during and in the immediate aftermath of the Second World War. In addition, the support for the French agricultural sector was a political *conditio sine qua non* for bringing an end to the catastrophic rhythm of wars in Europe.[14]

[11] Working Party Report, *Netherlands Action under Article XXIII:2 to Suspend Obligations to the United States*, L/61, adopted 8 November 1952, B.I.S.D. 1S/62; cf. John H. Jackson, *World Trade and the Law of the GATT* (Bobbs-Merrill Company, 1969) 733–7.

[12] This is not an historic phenomenon. cf., for example, H.R.2646—Farm Security and Rural Investment Act of 2002, available at <http://thomas.loc.gov/cgi-bin/query/z?c107:H.R.2646.ENR:> and recently the 'Agricultural Act of 2014', Publ.L 113–79, at <http://www.gpo.gov/fdsys/pkg/PLAW-113publ79/html/PLAW-113publ79.htm>; cf. Vincent Smith, 'The 2014 Agricultural Act—U.S. Farm Policy in the context of the 1994 Marrakesh Agreement and the Doha Round', ICTSD Issue Paper 5, Geneva 2014.

[13] cf. Kenneth W. Dam, *The GATT: Law and the International Economic Organization* (University of Chicago Press, 1977) 260.

[14] The current legal basis for the EU's CAP can be found in four regulations: Regulation (EU) No. 1305/2013 of the European Parliament and of the Council of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No. 1698/2005, OJ L 347, 20 December 2013, 487–548; Regulation (EU) No. 1306/2013 of the European Parliament and of the Council of 17 December 2013 on the financing, management and monitoring of the common agricultural policy and repealing Council Regulations (EEC) No. 352/78, (EC) No. 165/94, (EC) No. 2799/98, (EC) No. 814/2000, (EC) No. 1290/2005 and (EC) No. 485/2008, OJ L 347, 20 December 2013, 549–607; Regulation (EU) No. 1307/2013 of the European Parliament and of the Council of 17 December 2013 establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy and repealing Council Regulation (EC) No. 637/2008 and Council Regulation (EC) No. 73/2009, OJ L 347, 20 December 2013, 608–70; Regulation (EU) No. 1308/2013 of the European Parliament and of the Council of 17 December 2013 establishing a common organisation of the markets in agricultural products and repealing Council Regulations (EEC) No. 922/72, (EEC) No. 234/79, (EC) No. 1037/2001 and (EC) No. 1234/2007, OJ L 347, 20 December 2013, 671–854.

The measures of choice for the GATT membership were subsidies, such as rural income improvements, rural rehabilitations, and improvements of food supply.[15] Variable import levies served to raise the price of imported products to the government-determined domestic target price of the product.[16] Once surpluses developed, nobody shied away from shipping them to foreign shores, if need be with a little help from the government: Whereas GATT had been amended to disallow export subsidies some eight years after coming into force, export subsidies for primary products were not even included in this prohibition.[17]

After countless GATT disputes,[18] at the 1982 Ministerial Meeting the GATT contracting parties declared the need for agriculture reform. Ministers stated their intention

> to bring agriculture more fully into the multilateral trading system by improving the effectiveness of GATT rules, provisions and disciplines and through their common interpretation; to seek to improve terms of access to markets; and to bring export competition under greater discipline.[19]

This was the starting point for negotiating an agricultural trade regime that was to be normatively (and in practice) closer to non-agricultural goods. It helped that forty years after the last experience of hunger in the developed world, the budgetary burdens of agricultural policies met, in the EU and elsewhere, a less benevolent public opinion than had previously been the case.

In the Ministerial Declaration of Punta del Este of 1986, Ministers identified the agricultural system as an important issue for the upcoming Uruguay Round. The negotiations were to be focused on improving market access and reducing subsidies and other measures directly or indirectly distorting trade:

> The CONTRACTING PARTIES agree that there is an urgent need to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions including those related to structural surpluses so as to reduce the uncertainty, imbalances and instability in world agricultural markets. Negotiations shall aim to achieve greater liberalization of trade in agriculture and bring all measures affecting import access and export competition under strengthened and more operationally effective GATT rules and disciplines, taking into account the general principles governing the negotiations by:

[15] Robson de Moura Fernandes, *Exploring Different Legal Approaches to Defining Agricultural Export Subsidies in the WTO Agreements* (Cameron May, 2008) 201, 202.

[16] John Usher, *EC Agricultural Law*, 2nd edn. (Oxford University Press, 2001) 70; Joseph A. McMahon, *EU Agricultural Law* (Oxford University Press, 2007); Jens Hartig Danielsen, *EU Agricultural Law* (Alphen aan den Rijn: Wolters Kluwer, 2013).

[17] Terence P. Stewart, *The GATT Uruguay Round, Vol. I: Commentary. A Negotiating History (1986–1992)* (Kluwer, 1993) 125–254.

[18] cf., in addition to the cases already cited, for example, GATT Panel report, *European Economic Community—Restrictions on Imports of Apples—Complaint by the United States*, L/6513, adopted 22 June 1989, B.I.S.D. 36S/135; GATT Panel report, *European Economic Community—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, L/6627, adopted 25 January 1990, B.I.S.D. 37S/86.

[19] Ministerial Declaration Adopted on 29 November 1983, GATT Doc. L/5424, para. 7(v).

(i) improving market access through, inter alia, the reduction of import barriers;
(ii) improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade, including the phased reduction of their negative effects and dealing with their causes;
(iii) minimizing the adverse effects that sanitary and phytosanitary regulations and barriers can have on trade in agriculture, taking into account the relevant international agreements.[20]

Possibly for the first time, the pressure by the developing world had a significant impact: one of the South's key demands was the integration of both textiles and agricultural products into the liberalized trade regime. To some extent, both the United States and the EU—the two major agricultural subsidizers—welcomed the external pressure: as the costs for agricultural subsidies had become all but unsustainable, the WTO negotiations allowed leaders to externalize internal political costs incurred for cutting back on agricultural subsidies.

3. Non-trade Concerns in Agricultural Trade ('Multifunctionality')

Agriculture is often referred to as being 'multifunctional'.[21] The notion of multifunctionality describes the relationship between the production and its non-commodity output.[22] This is not unique to agriculture, as the discussion about the 'cultural exception' shows.[23] However, the non-economic consequences of agricultural production have played a significant role in trade policy since a very long time. In particular, the wealthy countries of the Northern hemisphere have, contrary to their regular approach to trade policy, openly embraced policies not compatible with the fundamental principles of the GATT/WTO trade regime.[24] Interestingly, however, some of the same non-trade concerns that are now being advanced by certain developing countries, most notably India, to justify restrictive measures, have previously been robustly attacked when practised by OECD countries.[25]

[20] Ministerial Declaration on the Uruguay Round, 20 September 1986, GATT Doc. MIN.DEC.

[21] cf. Fiona Smith, '"Multifunctionality" and "Non-Trade Concerns" in the Agriculture Negotiations' (2000) *Journal of International Economic Law* 3(4*)*, 707 *et seq.*

[22] cf. the comprehensive work by the OECD secretariat, <http://www.oecd.org/tad/agricultural-policies/multifunctionalityinagriculture.htm>.

[23] cf. Michael Hahn, 'A Clash of Cultures? The UNESCO Diversity Convention and International Trade Law' (2006) *Journal of International Economic Law* 9, 515–52.

[24] It is said that the first law of the United States was the so-called Hamilton Tariff, Sess. 1, ch. 2, 1 Stat. 2, concerning sugar.

[25] See the conclusions of the OECD study on 'Multifunctionality—Towards an Analytical Framework', 8, available at <http://www.oecd.org/dataoecd/43/31/1894469.pdf>; see also the Communication of the European Commission, 'The CAP towards 2020: Meeting the Food, Natural Resources and Territorial Challenges of the Future', Commission Doc. COM(2010) 672. cf. David Orden, David Blandford, and Tim Josling, eds., *WTO Disciplines on Agricultural Support: Seeking a Fair Basis for Trade* (Cambridge University Press, 2011); for an overview of developing countries' concerns see Alan Matthews, 'Food Security and WTO Domestic Support Disciplines post-Bali' (Geneva: ICTSD Programme on Agricultural Trade and Sustainable Development, 2014), 9 *et seq.*

Agricultural production is prototypically a multi-output production:[26] The by-products to an agricultural product (say, milk) are either jointly produced products,[27] such as hide and leather, meat, dung fertilizer, and/or externalities, such as the beauty of the European Alps.[28] The difference between a joint product and an externality is the ease with which the former can be valued, marketed, and commercialized: there are specific markets for milk, hides, and leathers. In contrast, markets for externalities have rarely existed: Whilst farming has created many landscapes all over the world, these benefits are considered public goods and inherently difficult to value.[29] Nevertheless, desirable external effects such as food security, the viability of rural areas, environmental protection, preservation of one's own cultural identity, and other non-trade concerns have dominated the debate on multifunctionality and are put forward as arguments for the exceptionally high degree of government support:[30]

Food security has two aspects: at an individual level, it is concerned with the ability of an individual to provide herself with food. This is far from being a theoretical concern only. Due to poverty and insufficient income, many individuals in the developing world lack food security.[31] At a collective level, states are keen to ensure that their population has access to the affordable supply of food necessary.[32] In this context, the highly volatile prices typical for agricultural commodities not only affect the affordability but rather may put producers out of business leading to a short-term shortage of foodstuffs.[33] Thus, price stabilisation would be one of the tools used for ensuring stable supply of agricultural products.

The *viability of rural areas* is linked to the attractiveness of the countryside as living space and the maintenance of both the cultural and natural heritage of a society. Declining employment in the agricultural sectors induces migration from rural areas to metropolitan areas, leading potentially to both rural depopulation (with significant consequences on agricultural production) and social difficulties in the destination of the migrants. In extreme cases, such depopulation may put into question the very existence of the state, as both, the element of population and government control, may be questioned by less than benevolent neighbours.[34]

[26] Jeffrey Peterson, Richard Boisvert, and Harry de Gorter, 'Multifunctionality and Optimal Environmental Policies for Agriculture in an Open Economy' in Merlinda Ingco and Alan Winters, eds., *Agriculture and the New Trade Agenda* (Cambridge University Press, 2005) 458–83.

[27] David Vanzetti and Els Wyen, 'The "Multifunctionality" of Agriculture and its Implications for Policy Agriculture in the WTO' in Merlinda D. Ingco and John D. Nash, eds., *Agriculture and the WTO—Creating A Trading System for Development* (World Bank, 2004) 167, 170.

[28] David Vanzetti and Els Wyen, 'The "Multifunctionality" of Agriculture', n. 27 at 171.

[29] Ibid. The main characteristics of a public good are the non-rivalry in consumption and the non-excludability, i.e. that no one can be excluded from the use of the public good on the basis of economic considerations.

[30] cf. AoA, Preamble, Art. 20, and Annex 5.

[31] Merlinda Ingco, Donald Mitchell, and John D. Nash, 'Food Security and Agricultural Trade Policy Reform, Agriculture in the WTO' in Ingco and Nash, eds., *Agriculture and the WTO* (2004) 179, 180.

[32] Kim Anderson, 'Agriculture's "Multifunctionality" and the WTO' (2000) *Australian Journal of Agricultural and Resource Economics* 44, 475, 481.

[33] See the Policy Report including contributions by FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank, the WTO, IFPRI, and the UN HLTF *Price Volatility in Food and Agricultural Markets: Policy Responses*, 2 June 2011, <http://www.amis-outlook.org/fileadmin/templates/AMIS/documents/Interagency_Report_to_the_G20_on_Food_Price_Volatility.pdf>.

[34] Kim Anderson, 'Agriculture's "Multifunctionality" and the WTO', n. 32 at 175.

As to *environmental externalities*: agriculture has shaped today's world. Keeping it working, irrespective of its *economic* sustainability, helps to conserve and preserve what has become the 'natural' habitat for humans, and animal and plant life. Apart from its recreational (and ideological) value—the great outdoors are often icons of national pride and as source for recreation—preserving the status quo has direct *environmental benefits*: rice paddies are said to prevent floods; using the Alps for agricultural purposes helps to prevent costly rock falls. Of course, there are negative externalities as well, as for instance pollution of water and soil, noise and fetidness.[35]

The support for agricultural producers is sometimes motivated (and often justified) by the wish to preserve such public goods, or, in the words of the EU Commission, 'the society's expectations'.[36] Whereas multifunctionality has traditionally been strongly supported by mature wealthy Northern hemisphere economies, developing countries and emerging economies used to criticize this approach as a smokescreen for protectionism of the 'Old World'.[37] These traditional front lines have somehow become less clearly defined as a consequence of the recent experience of food shortage brought about by climate change, continuing population growth, and the new important demand for biofuel raw materials.

The AoA does not explicitly refer to externalities and how to treat them under the multilateral framework. It does, however, exempt certain policy tools that have been used to advance some of the discussed public goods from the full discipline of the Agreement.[38] The AoA's preamble states that all 'commitments under the reform programme should be made in an equitable way among all Members, having regard to *non-trade concerns*, including food security and the need to protect the environment.'[39] More specifically, the members commit in AoA Article 20(c) to include non-trade concerns in future negotiations.

4. The Agreement on Agriculture: An Overview

4.1 Product coverage

The AoA does not provide an explicit definition of the term 'agricultural product'. Rather, it refers in its Annex 1 to all products listed under the Harmonized System (HS) Chapters 1 to 24, and thirteen other categories, for example hides and skins.[40] Only fish and fish products—two highly important sources of protein for large parts of the world—are excluded. Hence, the AoA's coverage encompasses not only basic agricultural products such as wheat, milk, and live animals, but also highly processed agricultural products such as bread, butter, cheese, chocolate, sausage,

[35] David Vanzetti and Els Wyen, 'The "Multifunctionality" of Agriculture', n. 27 at 174.

[36] European Commission, *The European Model of Agriculture—The Way Ahead*, <http://trade.ec.europa.eu/doclib/docs/2005/april/tradoc_122241.pdf>.

[37] Fiona Smith, '"Multifunctionality" and "Non-Trade Concerns" in the Agriculture Negotiations', n. 21 at 713; for indications that some of these concerns are far from being unrealistic see Hans-Ulrich Gössl, 'EU Trade Policy and Non-Trade Issues: The Case of Agricultural Multifunctionality' (2008) *European Foreign Affairs Review* 13, 211, 221.

[38] AoA, Annex 2.

[39] AoA, Preamble.

[40] Listed under the HS heading 41.01–41.03 and raw hemp, listed under HS Heading 53.02.

wine, or distilled spirits. In addition, the coverage extends to raw silk, cotton, flax, and similar materials used for textile production. On the other hand, not only fish and fish products, but also forestry products and rubber are excluded from AoA coverage, despite their being important agricultural product categories for many countries.[41]

This haphazard regime is not in line with the usual usage of the term 'agricultural good', both in plain English and in international practice, for example, in the UN Food and Agriculture Organization.[42] These inconsistencies have become even more pronounced due to the appearance of biofuels, of which some are captured whereas others are not.[43] However, it seems that the issue of product coverage will not be addressed in the near future.[44]

4.2 Substantive provisions

The declared purpose of the AoA to contribute to a 'fair and market-oriented agricultural trading system' expresses in sophisticated treaty language the political will of the negotiators to bring agriculture *closer* to the normal WTO regime for goods. Indeed, the incremental increase of producers' market exposure and the incremental decrease of permissible state aid is what the three operational modules of commitments of the AoA, its famous 'Three Pillars', aim to bring about: (1) improved market access (AoA Part III, Arts. 4 and 5), (2) the new, more restrictive regime for domestic support (AoA Part IV, Arts. 6 and 7), and (3) the reduced scope for export subsidies (AoA Part V, Arts. 8 to 11). In addition to this three-pronged centrepiece of the AoA, other provisions, notably those on export prohibitions and restrictions, are increasingly significant and merit a discussion.[45]

4.3 Relationship to other WTO agreements

Agricultural products are goods for the purposes of WTO law. Therefore, the regular rules governing the trade-relevant aspects of state measures affecting goods apply, with two areas being particularly pertinent. These are the WTO rules on subsidization (the pervasiveness of agricultural subsidies has already been pointed out) and the WTO law

[41] AoA, Annex 1, para. 1(i).

[42] cf. Margaret A. Young, 'Fragmentation or Interaction: The WTO, Fisheries Subsidies and International Law' (2009) *World Trade Review* 8, 477; see also the Indian proposal to include rubber, jute, and sisal into the covered products, G/NG/AG/W102, 15 January 2001, 5 and the forestry saga between the United States and Canada on softwood lumber, for example, *US—Softwood Lumber VI (Article 21.5—Canada)* (Appellate Body). However, the SPS Agreement would apply since it is not limited by the product coverage determined in the AoA: Annex 1, para. 2; indeed one of the first SPS cases deals with fish: *Australia—Measures Affecting Importation of Salmon*.

[43] Stephanie Switzer and Joseph A. McMahon, 'EU Biofuels Policy-Raising the Question of WTO Compatibility' (2011) *International & Comparative Law Quarterly* 60, 713.

[44] WTO, Revised Draft Modalities for Agriculture, TN/AG/W/4/Rev.4, 6 December 2008. In WTO parlance, the term 'modalities' is employed as a synonym for negotiated outlines for final commitments.

[45] Baris Karapinar and Christian Haeberli, *Food Crises and the WTO* (Cambridge University Press, 2010); Thomas J. Schoenbaum, 'Fashioning a New Regime for Agricultural Trade: New Issues and the Global Food Crisis' (2011) *Journal of International Economic Law* 14, 375.

on state measures that concern the health and safety of agricultural products (consolidated in the SPS Agreement), as agricultural products are not only consumed by humans and animals on a daily basis, but may also affect the flora and fauna and even the agricultural production of the import country, for instance through the introduction of infectious diseases.

In addition to these general rules concerning state measures affecting trade in goods, the AoA sets up a *lex specialis* for state measures related to agricultural production and trade. It is listed in Annex 1A of the WTO Agreement and hence, pursuant to Article II:2 of the WTO Agreement, an integral part of that Agreement and binding on all members; it is also, of course, a 'covered agreement' for the purposes of the Dispute Settlement Understanding (DSU).[46]

The relationship between *lex generalis* and *lex specialis* is interesting for many constellations of WTO law. It will be recalled that the general interpretative note to Annex 1A of the WTO Agreement gives precedence to the provision of the specialized agreements contained in Annex 1A *in case of conflict* with the provisions of GATT.[47] In *Brazil—Desiccated Coconut*,[48] Brazil imposed countervailing duties on desiccated coconut imports from the Philippines.[49] The question arose whether countervailing duties could be based solely on GATT Article VI, independently from the provisions of a more specific agreement. The Appellate Body, confirming the Panel, stated:

> The *Agreement on Agriculture* and the *SCM Agreement* reflect the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies. The general interpretative note to Annex 1A was added to reflect that the other goods agreements in Annex 1A, in many ways, represent a substantial elaboration of the provisions of the GATT 1994, and to the extent that the provisions of the other goods agreements conflict with the provisions of the GATT 1994, the provisions of the other goods agreements prevail.[50]

However, the *lex specialis* provisions of the specialized multilateral agreements on trade in goods (WTO Agreement, Annex 1A) do not automatically replace the provisions of the GATT,[51] as made clear by AoA Article 21.1:

> The provisions of the GATT 1994 and the Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement.[52]

Thus, the provisions of GATT 'apply to . . . agricultural products, except to the extent that the [Agreement] contains specific provisions dealing specifically with the same matter.'[53]

In *Chile—Price Band System*, the Appellate Body determined the *order of analysis* by examining the compatibility of a measure first under AoA Article 4.2, before turning to

[46] cf. DSU Art. 1.1 and Appendix 1(B). [47] Emphasis added.
[48] *Brazil—Desiccated Coconut* (Appellate Body).
[49] *Brazil—Desiccated Coconut* (Panel), para. 1.
[50] *Brazil—Desiccated Coconut* (Appellate Body), 14.
[51] *Brazil—Desiccated Coconut* (Panel), para. 227. This line of interpretation was confirmed in *EC—Bananas* where the Appellate Body interpreted this provision as mandating that, to the extent that the AoA contains specific provisions that deal with the same matter as the other agreements contained in Annex 1A, the AoA prevails; see *EC—Bananas III* (Appellate Body), para. 155.
[52] Art. 21.1 AoA. [53] *EC—Bananas III* (Appellate Body), para. 155.

GATT Article II:1(b). If a measure was inconsistent with the market access obligations under AoA Article 4.2, there was no need, according to the Appellate Body, also to examine GATT Article II:1(b). The pertinent measure had not been converted into an ordinary customs duty, and thus, there was no duty that could actually have been subject to the commitments under GATT Article II:1(b). The application of a measure that *is* consistent with AoA Article 4.2 is nevertheless limited to the commitments made in the member's schedule.[54]

The even more important relationship between the AoA and the SCM Agreement is addressed in *US—Upland Cotton*. Again, the analysis started with the AoA, followed by the SCM Agreement and, finally, the GATT. Again, the Appellate Body interpreted AoA Article 21.1 'to mean that the provisions of the GATT 1994 and of other Multilateral Trade Agreements in Annex 1A apply, "except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter"'.[55] Exemplifying the situations in which the AoA would prevail the report states:

> [F]or example, the domestic support provisions of the *Agreement on Agriculture* would prevail in the event that an explicit carve-out or exemption from the disciplines in Article 3.1(b) of the *SCM Agreement* existed in the *text* of the *Agreement on Agriculture*. Another situation would be where it would be impossible for a Member to comply with its domestic support obligations under the *Agreement on Agriculture* and the Article 3.1(b) prohibition simultaneously.[56]

Remarkably, the Appellate Body did not view in the right of members to subsidize, within the limits of their schedules maximum support pursuant to AoA Article 6.3, an exemption from the general prohibition in Article 3.1(b) of the SCM Agreement to use subsidies 'contingent ... upon the use of domestic over imported goods'.[57] Thus, an examination of the WTO-compatibility of agricultural support measures must not stop with examining the AoA-compatibility of the measure in question. Rather, even an AoA-compatible measure will have to meet the standards of the SCM Agreement, unless the latter is *specifically* pre-empted by AoA provisions; whether that is the case will ultimately be decided by the Appellate Body.

5. The Agreement on Agriculture's Market Access Provisions

5.1 Overview

Improving market access for agricultural products was the first issue addressed in the declaration of Punta del Este[58] and is also the first issue addressed in the AoA. In a

[54] *Chile—Price Band System System* (Appellate Body), para. 190.

[55] *US—Upland Cotton* (Appellate Body), para. 532, referring to *EC—Bananas III* (Appellate Body), para. 155 and *Chile—Price Band System* (Appellate Body), para. 186. See also *EC—Export Subsidies on Sugar* (Appellate Body), paras. 221–2.

[56] *US—Upland Cotton* (Appellate Body), para. 532 (emphasis in the original); cf. also the reference to another scenario introduced by the Panel in its report, ibid.

[57] *US—Upland Cotton* (Appellate Body), para. 545.

[58] GATT, Punta del Este Ministerial Declaration on the Uruguay Round of 20 September 1986, Part D, 'Agriculture', paras (i)–(iii), B.I.S.D. 33S/19.

distinct paradigm shift, the tariffs-only principle of the GATT (cf. Article II, read together with GATT Article XI) is extended to agricultural products by converting (substantially all) non-tariff measures (that rendered market access of agricultural products more difficult) into tariffs. This conversion alone would have rendered the status quo more transparent without, however, entailing any improvement of market access opportunities. Therefore, members committed to reduce the newly calculated tariff lines. In addition, the AoA established a minimum market access guarantee for products which had not yet—or only rarely—been imported.[59]

5.2 Tariffication and reduction commitments

It is one of the received wisdoms that tariffs are the WTO's trade-restrictive measure of choice due to their being transparent and thus best suited for reduction in future trade negotiations.[60] Putting their money where their mouth had been since 1947, members undertook in AoA Article 4.2 to proceed with the 'tariffication' of their non-tariff market-access barriers (NTBs):

> Members shall not maintain, resort to, or revert to any measures of the kind which have been required to be converted into ordinary customs duties, except as otherwise provided for in Article 5 and Annex 5.[61]

A footnote to AoA Article 4.2 specifies the NTBs covered:

> These measures include quantitative import restrictions, variable import levies, minimum import prices,[62] discretionary import licensing, non-tariff measures maintained through state-trading enterprises, voluntary export restraints, and similar border measures other than ordinary customs duties,[63] whether or not the measures are maintained under country-specific derogations from the provisions of GATT 1947, but not measures maintained under . . . non-agriculture-specific provisions . . . of the other Multilateral Trade Agreements in Annex 1A to the WTO Agreement.[64]

In order to calculate the tariff equivalent of a non-tariff-measure, members used the price-gap method[65] pursuant to Annex 3 of the 'Modalities Agreement':[66] the difference of the domestic market price to the world market price equals the new tariff. The pertinent base period were the years 1986–88 which were characterized by a stark

[59] Merlinda Ingco and John Croome, 'Trade Agreements: Achievements and Issues Ahead' in Merlinda Ingco and John D. Nash, eds., *Agriculture in the WTO* (World Bank Publications, 2004) 23, 27.

[60] See, for example, the statement in *Turkey—Rice* (Panel), para. 9.63.

[61] AoA Art. 4.2.

[62] See *Chile—Price Band System* (Appellate Body), paras. 236–7; *Chile—Price Band System (Article 21.5—Argentina)* (Appellate Body), paras. 198, 201–2.

[63] See *Chile—Price Band System* (Appellate Body), para. 226; *Chile—Price Band System (Article 21.5—Argentina)* (Appellate Body), paras. 163–4, 167–9, 188–9.

[64] AoA Art. 4.2, fn. 1.

[65] Merlinda Ingco and John Croome, 'Trade Agreements: Achievements and Issues Ahead', n. 59 at 28.

[66] *Modalities for the Establishment of Specific Binding Commitments under the Reform Programme*, MTN.GNG/MA/W/24, December 1993.

price gap between the domestic market price and the world market price. As a result, very high tariffs ('dirty tariffication') are common.[67]

Following the conversion of quantitative restrictions into tariffs, members were obliged—as a second step—to reduce tariffs. Developed countries accepted the commitment to reduce their overall tariffs by 36 per cent, and by at least 15 per cent for any product category within the implementation period from 1995–2000.[68] For developing countries, the pertinent reduction obligation amounted to 24 per cent overall with a minimum of 10 per cent, within a period of ten years; least developed countries did not have to enter into any such reduction commitment.[69] After the end of the implementation period, the tariffs were included in the schedules of commitments and thereby became binding.[70] As a consequence, members are bound to not raise tariffs above the scheduled level; lower rates are possible either on a most favoured nation (MFN) basis or exceptionally, for example, on the basis of an Article XXIV GATT-compatible free trade agreement (FTA).

The question whether and when a measure was subject to conversion into an *ordinary custom duty* was addressed by *Chile—Price Band*.[71] Chile maintained a system under which the tariff rate of certain imported agricultural products could be adjusted to international price developments, if the price of the product in the domestic market fell below or rose beyond a certain threshold.[72] The complainant (Argentina) claimed that this price band system was a measure covered by the tariffication obligation pursuant to AoA Article 4.2. It argued that the duties levied on the basis of the existing price band system were not *ordinary customs duties* and thus were inconsistent with AoA Article 4.2.[73] The Appellate Body agreed. It compared the Chilean measure to several examples of measures listed in footnote 1:

> The footnote imparts meaning to Article 4.2 by enumerating examples of "measures of the kind which have been required to be converted", and which Members must not maintain, revert to, or resort to, from the date of the entry into force of the *WTO Agreement*... [T]he use of the word "include" in the footnote indicates that the list of measures is illustrative, not exhaustive. And, clearly, the existence of footnote 1

[67] Melaku Geboye Desta, *The Law of International Trade in Agricultural Products* (Kluwer Law International, 2002) 75; Harry De Gorter, Merlinda Ingco, Laura Ignacio, and Jana Hranaiova, 'Market Access: Agricultural Policy Reform and Developing Countries' in *Trade Note 6* (World Bank, 2003).

[68] *Modalities for the Establishment of Specific Binding Commitments under the Reform Programme*, MTN.GNG/MA/W/24, para. 5 et seq.

[69] Ibid. paras. 15 and 16.

[70] In the case of agricultural products, Part 1A of a schedule covers tariffs, Part IB covers tariff quotas; minimum access was guaranteed through tariff quotas in accordance with the mechanism in GATT, Modalities for the Establishment of Specific Binding Commitments under the Reform Programme, MTN.GNG/MA/W/24, 20 December 1993 (in the following: Modalities Agreement), Annex 3B. The latter are 'not a covered agreement and thus cannot provide for WTO rights and obligations to Members. Nonetheless, [they] could be relevant when interpreting the Agreement on Agriculture, including Members' Schedules'; *EC—Export Subsidies on Sugar* (Panel), para. 7.350.

[71] cf. Kyle Bagwell and Alan Sykes, 'Chile—Price Band System and Safeguard Measures Relating to Certain Agricultural Products' (2004) *World Trade Review* 3, 507–28.

[72] *Chile—Price Band System* (Appellate Body), paras. 15–30.

[73] *Chile—Price Band System* (Appellate Body), para. 68.

> suggests that there will be "measures of the kind which have been required to be converted" that were *not* specifically identified during the Uruguay Round negotiations. Thus, . . . the illustrative nature of this list lends support to our interpretation that the measures covered by Article 4.2 are not limited only to those that were *actually* converted, or were requested to be converted, into ordinary customs duties during the Uruguay Round.[74] . . .
>
> . . . *[A]ll* of the border measures listed in footnote 1 have in common the object and effect of restricting the volumes, and distorting the prices, of imports of agricultural products in ways different from the ways that ordinary customs duties do. Moreover, *all* of these measures have in common also that they disconnect domestic prices from international price developments, and thus impede the transmission of world market prices to the domestic market.[75]

According to the Appellate Body, the characteristics of the variable import levies in question undermined the purpose of AoA Article 4 to ensure fair market access based on transparent tariffs.[76] The fact that the Chilean price band system based the additional duty on a benchmark determined once a week and according to current prices in markets that were of importance for Chile, made the system, in the Appellate Body's view, insufficiently transparent and predictable.[77] The Appellate Body also emphasized that providing a specific market access exception through the installation of

> a special safeguard provision under Article 5[,] implies that Article 4.2 should *not* be interpreted in a way that permits Members to maintain measures that a Member would not be permitted to maintain *but for* Article 5, and, much less, measures that are even more trade-distorting than special safeguards. In particular, if Article 4.2 were interpreted in a way that allowed Members to maintain measures that operate in a way similar to a special safeguard within the meaning of Article 5—but without respecting the conditions set out in that provision for invoking such measures—it would be difficult to see how proper meaning and effect could be given to those conditions set forth in Article 5.[78]

Turning to the examination of the term 'ordinary custom duty', the Appellate Body reiterated that ordinary customs duties must be expressed in the form of *ad valorem* or specific rates. It drew on the fact that the term 'ordinary custom duty' is also used in GATT Article II:1(b), distinguishing the custom duties indicated in the schedule from 'other duties or charges':[79]

> Contextual support for interpreting the term "ordinary customs duties" also appears in Annex 5 to the *Agreement on Agriculture*. Annex 5, read together with the Attachment to Annex 5 (*Guidelines for the Calculation of Tariff Equivalents for the Specific Purpose Specified in Paragraphs 6 and 10 of this Annex*), contemplates the calculation of "tariff

[74] Ibid. para. 209 (emphasis in the original).
[75] Ibid. para. 227 (emphasis in the original).
[76] Ibid. paras. 232 *et seq.*, 236–7.
[77] Ibid. para. 237.
[78] Ibid. para. 217 (emphasis in the original).
[79] Melaku Geboye Desta, *The Law of International Trade in Agricultural Products*, n. 67 at 70.

equivalents" in a way that would result in ordinary customs duties "expressed as *ad valorem* or specific rates".[80]

The fact that the Chilean price band system resulted in levies that took the *form* of ordinary custom duties[81] was considered insufficient to make them consistent with AoA Article 4.2. Rather, the Chilean price band system was found to be similar to the measures listed in footnote 1 of AoA Article 4.2.[82]

In *Turkey—Rice*, the 'Certificates of Control' required by Turkey for each import on rice were challenged as being in violation of AoA Article 4.2. Every trader wishing to import rice had to obtain this document from the Turkish Ministry of Agriculture and Foreign Affairs and show it to Customs.[83] The Panel accepted the US viewpoint that Turkey's refusal or failure to grant these certificates for rice falling outside of the tariff quota amounted to a quantitative import restriction pursuant to footnote 1 of AoA Article 4.2.[84] Although the denial of certificates to import rice did not affect the level of duties, it nevertheless led to a lack of transparency and predictability and was therefore viewed as a measure similar to the one listed in footnote 1, likely to restrict imports.[85]

5.3 Current and minimum market access

Eliminating quotas through the process of tariffication created the danger that pre-existing market access for exporters would be lost when and if tariffication led to prohibitively high tariffs. To avoid this undesirable consequence, members guarantee minimum market access based on past market penetration through import-favouring tariffs quotas. If an imported product had acquired less than 5 per cent market share historically, the quota had to be calculated so as to satisfy at least 3 per cent of domestic consumption in the base period (1986–88); this minimum had to be lifted to at least 5 per cent by the end of the implementation period in 2000.[86] If, historically, the imported product had attracted 5 per cent or more of domestic consumption, that percentage had to be preserved and increased over the implementation period.[87] The tool to ensure this minimum market access are tariff rate quotas (TRQs), for which lower tariffs than those resulting from the tariffication process apply; forty-three members currently have such tariff quotas.[88] Any expansion of access opportunities under the tariff rate quota system has to be provided on an MFN basis.[89]

EC—Bananas III[90] discussed whether the basic principles of GATT Article XIII also apply to tariff rate quotas under the AoA. The EC maintained a scheme of different tariff rate quotas relating to the importation of bananas. A first category of bananas

[80] *Chile—Price Band System* (Appellate Body), para. 277 (emphasis in the original).
[81] Ibid. para. 278, fn. 254.
[82] The Appellate Body emphasized that due to AoA Art. 4.2 being 'drafted in the present perfect tense... [this] ensure[d] that measures that were required to be converted as a result of the Uruguay Round—but were not converted—could not be maintained, by virtue of that Article, from the date of the entry into force of the *WTO Agreement* on 1 January 1995': ibid. para. 207.
[83] *Turkey—Rice* (Panel), para. 7.18. [84] Ibid. paras. 7.12, 7.118 *et seq.*
[85] Ibid. para. 7.120. [86] Modalities Agreement, MTN.GNG/MA/W/24, para. 5.
[87] Ibid. para. 6.
[88] cf. <http://www.wto.org/english/tratop_e/agric_e/negs_bkgrnd07_access_e.htm>.
[89] cf. Modalities Agreement, MTN.GNG/MA/W/24, para. 11. [90] *EC—Bananas III.*

would enter the market duty-free; the second category would enter at a tariff rate of 75 ECU/t, and a third category at a tariff rate of 822 ECU/t.[91] More than 50 per cent of the tariff quotas for the second category had been allocated to 'closer' partners of the EU, in particular the African, Caribbean, and Pacific (ACP) states, often linked through historical bonds to France and Great Britain. Central and South American states, together with the United States, complained that this allocation of tariff rate quotas was inconsistent with the non-discrimination disciplines of GATT Article XIII. Invoking the priority rule of AoA Article 21.1, the EC claimed that the commitments under AoA Article 4.1—allowing 'other market access commitments as specified'[92] in the schedule—replaced the appropriate provisions of the GATT.[93] The Appellate Body rejected this argumentation:

> The [AoA] contains several specific provisions dealing with the relationship between articles of the [AoA] and the GATT 1994. For example, Article 5 [AoA] allows Members to impose special safeguards measures that would otherwise be inconsistent with Article XIX of the GATT 1994 and with the *Agreement on Safeguards*. In addition, Article 13 [AoA] provides that, during the implementation period for that agreement, Members may not bring dispute settlement actions under either Article XVI of the GATT 1994 or Part III of the [SCM-Agreement] for domestic support measures or export subsidy measures that conform fully with the provisions of the [AoA]. . . .
>
> The negotiators of the [AoA] did not hesitate to specify such limitations elsewhere in that agreement; had they intended to do so with respect to Article XIII of the GATT 1994, they could, and presumably would, have done so.[94]

5.4 Limitations and exemptions

5.4.1 Special treatment and GATT exceptions, Article 4.2 and Annex 5

A broad exception to the main discipline of tariffication (AoA Article 4), is found in Annex 5 (referred to in AoA Article 4.2), which allows under certain conditions a special treatment for two categories of products: (1) products 'being subject to special treatment reflecting factors of non-trade concerns, such as food security and environmental protection' (Section A), and (2) primary agricultural products that are 'the predominant staples in the traditional diet of a developing country' (Section B).[95] Japan, Korea, and the Philippines had reserved special treatment for rice, whereas Israel used that option for sheep meat and cheese. However, no further examples have been recorded; meanwhile Japan has already dropped the special treatment for rice.[96]

[91] *EC—Bananas III* (Panel), para. 16.
[92] AoA Art. 4.1.
[93] *EC—Bananas III* (Appellate Body), para. 20.
[94] Ibid. para. 157 (emphasis in the original).
[95] Annex 5:B.7.
[96] Korea and the Philippines have extended their special treatment for rice, cf. WTO Doc. G/AG/W/62, 20 January 2004 and G/AG/W/63, 29 March 2004. Japan, Israel, and Chinese Taipei have tariffied the products concerned, cf. WTO Doc. G/MA/TAR/RS/57, 21 December 1998; G/MA/TAR/RS/88, 16 October 2002 and G/MA/TAR/RS/88/Corr.1, 24 October 2002.

According to footnote 1 of AoA Article 4.2, a derogation from the obligation not to maintain, resort, or revert to a non-tariff measure does not apply to 'measures maintained under balance-of-payments provisions or under other general, non-agriculture-specific provisions' of any of the WTO agreements on trade in goods.[97] In *India—Quantitative Restrictions*, India restricted imports (by non-tariff measures), claiming necessity due to balance of payments problems pursuant to GATT Article XVIII. The Panel found that India had violated both GATT Article XI:1 and AoA Article 4.2: quantitative import restrictions had to be converted to tariffs without any right of members to revert back to them. A possible justification under GATT Article XVIII could neither be demonstrated nor proven.[98]

5.4.2 AoA Article 5 special safeguard provisions

The AoA's conversion of all non-tariff measures into tariffs renders the conditions for market access more transparent and predictable. While a tariff has the function of a (not-for-free!) entry ticket permitting market access, the scheduled rate determines, in a transparent and predictable manner, its price. Safeguard measures nullify that effect, which is not just in itself undesirable for the trading partners, but takes away an advantage that in all likelihood has been 'paid for' by corresponding reciprocal trade liberalization measures. Be that as it may, pursuant to GATT Article XIX and the Agreement on Safeguards (in particular its Article 2.1), members may deviate from the scheduled tariff's upper limit, if (exceptionally) the consequences of trade liberalization manifest themselves through 'recent', 'sudden', 'sharp', and 'significant' increases of imports that 'cause or threaten to cause "serious injury"'.[99] This well-established integral part of general *trade remedies law* was viewed as being even more necessary for the agricultural industries, hitherto largely insulated from competition, as many Northern OECD countries were concerned with massive disruptions of domestic agricultural production as a consequence of sudden and unpredictable surges of aggressively priced imports.[100] Regardless of whether these fears were well-founded, they threatened to derail acceptance of the WTO agreement in developed countries.

Thus, the AoA introduces Special Safeguard Measures (SSGs) as a tool available to all members that undertook tariffication: AoA Article 5.5(a) to (c) permits, in a manner similar to other trade remedies, the raising of import levies beyond the scheduled maximum level,[101] provided the yearly volume of imports in any given product category surpasses the threshold (trigger) level of 105–125 per cent of the import volumes of the preceding three-year period.[102] Alternatively, SSGs may be used if a product's import prices drop below a certain trigger price; this threshold is defined by

[97] Included in Annex 1A to the WTO Agreement.

[98] *India—Quantitative Restrictions* (Panel), para. 5.241.

[99] *Argentina—Footwear (EC)* (Appellate Body), para. 131.

[100] Melaku Geboye Desta, *The Law of International Trade in Agricultural Products*, n. 67 at 86.

[101] A volume-based SSG may only be maintained until the end of the year in which it has been imposed (AoA Art. 5.1(a)); additional duties shall not exceed one third of the ordinary custom duty at the time of the measure.

[102] AoA Art. 5.1(a).

the average price in the three-year period 1986–1988.[103] For instance, undercutting the trigger prices by 40 per cent may justify an additional 10 per cent duty surcharge, whereas undercutting by 60 per cent would even allow a surcharge of 20 per cent.[104]

The SSG tool is only available to members that have added (in their respective tariff schedules) the specification 'SSG' to each agricultural product they consider to be sensitive: thirty-nine WTO members have availed themselves of that opportunity, covering more than 6,000 products.[105] The most aggressive user has been Switzerland, which reserved the use of SSG for 961 products, followed by Norway with 581 products and the EU with 539.[106]

In *EC—Poultry*, the Appellate Body had to address how price-based SSG had to be calculated.[107] The EC had used safeguard measures on out-of-quota imports of poultry. Brazil claimed that the EC had violated AoA Article 5.1(b) by basing the trigger price on the c.i.f. price. In Brazil's opinion, the trigger price should have been the c.i.f. import price *plus* the bound duty,[108] thus arguing in effect for a higher threshold. On that point, the Appellate Body sided with the EC:

> The relevant import price in Article 5.1(b) is described as "the price at which imports of that product *may enter the customs territory* of the Member granting the concession, as determined on the basis of the c.i.f. import price of the shipment concerned".... [T]he "price at which that product may enter the customs territory" of the importing Member should be construed to mean just that—the price at which the product may enter the *customs territory*, not the price at which the product may enter the *domestic market* of the importing Member. And that price is a price that does not include customs duties and internal charges. It is upon entry of a product into the customs territory, but before the product enters the domestic market, that the obligation to pay customs duties and internal charges accrues.[109]

However, this was cold comfort for the EU, as the Appellate Body rejected its methodology, which used an average import price calculated on the basis of a certain

[103] AoA Art. 5.1(b). The disciplines for price-based SSGs are explained in Art.5.1(b). The member can invoke the price-based SSG, if the c.i.f. import price falls below a trigger price, i.e. the averaged reference price of 1986–88. A footnote to Art. 5.1(b) bases this reference price on the average c.i.f. unit value of the product concerned. A schedule is listed in Art. 5.5(a). Or the method of calculating the price-based SSG is set out in AoA Art. 5. The price safeguard provisions are set out in AoA Arts. 5.1(b) and 5.5. Art. 5.1(b) provides specific conditions for special safeguard provisions related to price, in addition to the two general conditions of Art. 5.1. If the market entry price (expressed in terms of domestic currency) falls below a trigger price, the provisions of Art. 5.5 come into play and an additional duty may be applicable to the shipment in question. For the price-based SSG, the trigger price is the average 1986–88 c.i.f. price and the additional rate of import duty depends on the difference between the trigger price and the price of the imported product.

[104] cf. Jai S. Mah, 'Reflections on the Special Safeguard Provision in the Agreement on Agriculture of the WTO' (1999) *Journal of World Trade* 33, 197 *et seq.*

[105] cf. <http://www.wto.org/english/tratop_e/agric_e/negs_bkgrnd11_ssg_e.htm> and Committee on Agriculture—Special Session, 'Special Agricultural Safeguard', Background Paper by the Secretariat, Revision, WTO Doc. G/AG/NG/S/9/Rev.1 (19 February 2002).

[106] G/AG/NG/S/9, 6 June 2000, 5, <http://www.wto.org/english/tratop_e/agric_e/negoti_ph1_e.htm#secretariat>. About one sixth of total reserved SSG fall on cereals and more than one sixth on animals and animal products, ibid.

[107] *EC—Poultry* (Appellate Body), paras. 140–5.

[108] Ibid. para. 277.

[109] *EC—Poultry* (Appellate Body), para. 145 (emphasis in the original).

time period.[110] Rather, the Appellate Body held that the price to be measured against the trigger price had to be determined on a shipment-by-shipment basis.[111]

This restrictive approach to AoA Article 5.5 is an attempt to curtail an otherwise very generous justification to depart from trade liberalization in agricultural goods. As SSGs can be used without any injury test, it seems appropriate to opt for an interpretation that protects the *effet utile* of the basic norm. Note that whereas GATT Article XIX:1(a) and Article 2.1 of the Safeguards Agreement require the increased imports to cause or threaten serious injury to domestic producers, no such requirement is found in AoA Article 5. Hence, SSGs pursuant to AoA Article 5 can be activated without any substantial limitations, if there is an increase of volume or a decrease of prices, indicating that even today, agricultural goods are far from being subjected to standard WTO rules.[112] In addition, the re-balancing rights, provided by the general safeguards regime of the WTO that arguably allow unilateral reactions to the use of safeguards,[113] are specifically excluded. Pursuant to AoA Article 5.8, members undertake not to have recourse to either GATT Article XIX:1(a) or XIX:3, or Article 8:2 of the Safeguards Agreement with regard to measures taken in conformity with AoA Articles 5.1 to 5.7.

6. The Agreement on Agriculture's Domestic Support Provisions

The reduction of state subsidies for agricultural production was the second major goal of both agricultural exporting and importing members: the former pushed for them in order to advance their trade interest, the latter pushed back a little less than would have been the case in the Tokyo Round or before, due to the visible havoc these subsidies brought to members' budget plans.[114]

AoA Part IV (Articles 6, 7, and Annexes 2 to 4) sets out the conditions under which members may support their domestic industries. Whereas the AoA does not provide a definition of the term 'domestic support', it uses technical language ('subsidies') defined in the SCM Agreement. Therefore, Part IV covers all financial contributions or income support measures by a member that confer a benefit to a specific recipient.[115]

[110] Ibid. para. 163. [111] Ibid. para. 170.

[112] Pursuant to AoA Art. 5.7, any application of SSG must be notified to the WTO's Committee on Agriculture.

[113] Müslüm Yilmaz, 'The Legal Relationship between Special Safeguard Measures on Agricultural Products and General Safeguard Measures' (2009) *Global Trade and Customs Journal* 4, 87, 93; Michael Hahn, 'Balancing or Bending? Unilateral Reactions to Safeguard Measures' (2005) *Journal of World Trade* 39, 301 *et seq*.

[114] cf. Lars Brink, 'The WTO Disciplines on Domestic Support' in D. Orden, D. Blandford, and T. Josling, eds., *WTO Disciplines on Agricultural Support: Seeking a Basis for Fair Trade* (Cambridge University Press, 2011); André Nassar, Maria Elba Rodriguez-Alcalá, Cinthia Costa, and Saulo Nogueira, 'Agricultural Subsidies in the WTO Green Box: Opportunities and Challenges for Developing Countries' in Ricardo Meléndez-Ortiz, Christophe Bellmann, and Jonathan Hepburn, eds., *Agricultural Subsidies in the WTO Green Box: Ensuring Coherence with Sustainable Development Goals* (Cambridge University Press, 2009) 329–68.

[115] Art. 1 of the SCM Agreement; see in detail Chapter 10. AoA Art. 3.1 characterizes the domestic support commitments as 'limiting subsidization'; in the same vein, AoA Annex 3 adds to a list of support measures that includes price support or direct payment the words 'or any other subsidy'. See also Annex 3, s. 2: 'subsidies under paragraph 1'.

According to their potential to distort market conditions, the AoA provides for three categories of support measures which are designed to establish suitable regimes fitting their significantly differing trade-distorting effects:[116] the 'amber box' captures significantly trade-distorting measures such as market price supports; the 'green box' describes support measures that are viewed as not affecting other members; finally, the 'blue box' sets up a regime for measures so dangerous (for the trade interests of trade partners) that they are only permissible, if they are decoupled from production. There is no 'red box': Because export subsidies were moved out of the domestic support module, the third 'pillar' of the AoA on export subsidies is dedicated to them.[117]

6.1 'Amber box' measures

The aim of the Uruguay Round negotiators was to reduce domestic support measures that have a negative impact on the trading interest of other members. Thirty-eight members have undertaken to reduce support measures they granted in the past according to a timeline defined in the AoA. In order to do so, members have determined a maximum level[118] of support per year in their respective schedule, the 'annual and final bound commitment level'.[119] AoA Article 18.2 obliges the members to notify the Committee on Agriculture of any changes concerning the domestic support measures.

The first step for such containment and reduction was the establishment of an agreed formula to measure aggregate support. This is what the 'Total Aggregate Measurement of Support' (Total AMS) is about.[120] It is calculated by adding up all 'aggregated measurements of support', the calculation of which will be explained below.

6.1.1 Aggregated Measurement of Support

The 'Aggregate Measurement of Support' (AMS) is defined by AoA Article 1(a) as

> the annual level of support, expressed in monetary terms, provided *for an agricultural product* [emphasis added] in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general.[121]

[116] See Valentin Zahrnt, 'For a New Classification System of Domestic Support in the WTO Agreement on Agriculture' (2009) *Journal of World Trade,* Vol. 43, 1325, 1326.

[117] Merlinda Ingco and John Croome, 'Trade Agreements: Achievements and Issues', n. 59 at 31.

[118] AoA Art. 6.3.

[119] AoA Art. 6.1.

[120] AoA Art. 1(h).

[121] AoA Art. 1(a); pursuant to Art. 1(d), 'equivalent measurement of support' may be used provided that the use of AMS is impracticable. The overall support provided during the base period is called the 'base total AMS', AoA Art. 1(h)(i); it is the starting point for the reduction commitments set out in AoA Art. 6; an 'annual bound total AMS' determines the maximum level of support a member can provide during any year of the implementation period, AoA Art. 1(h)(ii).

A specific AMS is to be calculated for each product[122] receiving one of the three different types of domestic support: (1) market price support, (2) non-exempt direct payments, or (3) other non-exempt measures.[123] A *market price support system* is a subsidy scheme pursuant to which a government compensates the producer for the difference between the real-world market price and a government-determined 'fair' price (applied administered price).[124] In *Korea—Beef*,[125] both the Panel and the Appellate Body address in substantial detail how to correctly calculate market price support.[126]

The 'total AMS'—defined as the sum of the product-specific AMS, the non-product specific AMS, and the equivalent measurements of support[127]—serves as a benchmark for maximum support at the end of the implementation period ('final bound commitment level').[128] Members agreed to reduce their total AMS by 20 per cent by the end of the implementation period in 2000.[129] Developing countries were committed to reduce their total AMS by 13.3 per cent over nine years, whereas least developed countries are not required to fulfil any reduction commitments.[130] Much like GATT Article II:7, AoA Article 3.1 integrates each member's schedule into the GATT, rendering it an integral part of a 'covered agreement' for the purposes of the DSU.

6.1.2 *Exemptions from the calculation*

Several measures are exempt from AMS calculations and thus privileged. That is true in particular for small subsidies. According to AoA Article 6.4, the support measures need not be included in the calculation of the AMS if the product-specific support does not exceed 5 per cent of the overall value of the production *of that agricultural product* in the year concerned and if the non-product-specific support does not exceed 5 per cent of the total production's value. For developing countries—which of course include the major agricultural producers Brazil, China, and India—the *de minimis* threshold is 10 per cent.[131] 'Blue box' measures (AoA Article 6.5) and 'green box' measures (AoA Article 6.1) are also exempt from AMS calculations. Similarly, investment subsidies and agricultural input subsidies of developing countries are not required to be included in the calculation of the total AMS in order to encourage agricultural and rural development (AoA Article 6.2).

Unlike 'green box' measures (AoA Article 6.1), exemptions under AoA Article 6.2 *et seq*. were not fully protected under the 'peace clause' of AoA Article 13 and could be

[122] AoA Annex 3.6. [123] AoA Annex 3.8.

[124] Melaku Geboye Desta, *The Law of International Trade in Agricultural Products*, n. 67 at 398. Annex 3 lays down the acceptable methodology, to which AoA Art. 1(a)(ii) is referring; AoA Annex 4 does the same for the calculation of the equivalent measurement of support; see also AoA Annex 3 and Art. 1(b). Pursuant to Annex 3.8, the AMS for a product receiving market price support is calculated by multiplying the price difference between the domestic applied price and a fixed external reference price with the amount of production eligible to benefit from the applied administered price.

[125] *Korea—Beef* (Appellate Body).

[126] *Korea—Beef* (Appellate Body), para. 121 *et seq*.; see also *Korea—Beef* (Panel), paras. 829–44.

[127] AoA Art. 1(h). [128] AoA Art. 1(h)(i). [129] MTN.GNG/MA/W/24 para. 8.

[130] Art. 15.2. [131] AoA Art. 6.4(b).

challenged by other members, provided injury or threat of injury in accordance with GATT 1994 Article VI and Part V of the SCM Agreement could be shown.[132]

6.2 'Blue box' measures

Pursuant to AoA Article 6.5 '[d]irect payments under production-limiting programmes shall not be subject to the commitment to reduce domestic support if: (i) such payments are based on fixed area and yields; or (ii) such payments are made on 85 per cent or less of the base level of production; or (iii) livestock payments are made on a fixed number of head'.

The exemption of certain non-production-increasing practices by developed members, such as deficiency payments by the United States and arable area land and livestock headage payments pursuant to the EU's reformed CAP has been labelled 'blue box'.[133] As a general rule, direct payments made under *production limiting programmes* are excluded from the calculation of the current total AMS.[134] However, as both the United States (deficiency payments) and the EU have shifted support programmes to the 'green box', the 'blue box' is hardly used.

6.3 'Green box' measures

By virtue of AoA Article 6.1 and Annex 2, all measures that have no or minimal trade-distorting effects are exempted from any reduction commitment.[135] Unfortunately, the Appellate Body has refrained from defining the term 'minimal'.[136] However, a comparative analysis of what is considered 'de minimis'—both in the AoA and in other WTO agreements—should be a useful starting point for any analysis.[137] Pursuant to the AoA's Annex 2, paragraph 1, a measure qualifies for the green box, if

(a) the support in question shall be provided through a publicly funded government programme (including government revenue forgone) not involving transfers from consumers; and,
(b) the support in question shall not have the effect of providing price support to producers.

Specific conditions for coverage are listed in AoA's Annex 2 paragraph 2 ('Government Services Programmes'). Government programmes covered by this provision fall into

[132] AoA Art. 13(b)(i).
[133] Alan Swinbank and Richard Tranter, 'Decoupling EU Farm Support' (2005) *The Estey Centre Journal of International Law and Trade Policy* 6, 47, 48.
[134] AoA Art. 6.5(b).
[135] AoA Annex 2, para. 1.
[136] *US—Upland Cotton* (Appellate Body), para. 333: 'We note that the first sentence of paragraph 1 of Annex 2 lays down a "fundamental requirement" for green box measures, such that they must have "no, or at most minimal, trade-distorting effects or effects on production". The second sentence of paragraph 1 provides that, "[a]ccordingly", green box measures must conform to the basic criteria stated in that sentence, "plus" the policy-specific criteria and conditions set out in the remaining paragraphs of Annex 2, including those in paragraph 6'.
[137] See Thomas C. Beierle, 'Agricultural Trade Liberalization—Uruguay, Doha and Beyond' (2002) *Journal of World Trade* 36(6), 1098, 1101–8, for an analysis of the developing countries' position.

two groups: those that do not involve direct payments—such as the provision of certain beneficial services, public stockholding for food security purposes, and domestic food aid—and those which do. The latter are subject, in addition to the general discipline of Annex 2 paragraph 1 (cited earlier), to the specific disciplines listed in Annex 2 paragraph 6. Direct payment policies that may still benefit from green box exemption would include, for instance, direct payments to producers, decoupled income support, income insurance and income safety-net programmes, payments for relief from natural disasters, structural adjustments assistance, payments under environmental programmes, and payments under regional assistance programmes.[138]

Any modifications to an existing measure must fulfil the requirements set out in Annex 2 in order to benefit from continuing green box privileges, AoA Article 7.2(a).

The issue of de-coupled payments was raised in the *US—Upland Cotton*[139] dispute. The United States had introduced, through the FAIR Act, a scheme of production flexibility contract payments. Historic producers of upland cotton could enrol farmland upon which they had grown upland cotton during a base period. As a consequence, they were eligible for receiving payments in the future, regardless whether they chose to grow cotton. However, if recipient farmers decided to grow fruit and vegetables on the 'upland cotton base acres', payments would be reduced. This scheme was later replaced by direct payments, which were also dependent on base acres. Analogous to the production flexibility contract payments the farmers were—in principle—free to choose whether and what plant to grow. However, payments were still excluded if the farmers chose to grow fruit and vegetables.

Brazil challenged this measure as being not in conformity with paragraph 6(b) of Annex 2, pursuant to which 'the amount of such payments in any given year *shall not be related to*,[140] or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.' If 'related to' only captured *positive* connections to production, that is, requirement to produce, US payments would have been 'green box measures' pursuant to paragraph 6(b), since they did not *positively* require the farmers to produce. The Appellate Body, however, looked at the real-world consequences of the US provisions and decided that paragraph 6 addresses both positive as well as negative requirements.[141]

> In our view, the concepts of "type or volume of production . . . undertaken by the producer" and the "amount of . . . payments" are linked in paragraph 6(b) by the requirement that one "not be related to" the other. This requires a consideration of *the relationship* between the type or volume of production and the amount of payment under a program after the base period. A program that disallows payments when certain crops are produced relates the amount of the payment to the type of production undertaken. The flexibility to produce and receive payment for certain crops covered by a program, combined with the reduction or elimination of such payments when excluded crops are produced, creates a link with the type of production undertaken contrary to paragraph 6(b). This is so because the opportunity for farmers

[138] AoA Annex 2, paras. 2–13.
[139] *US—Subsidies on Upland Cotton* (Appellate Body), 3 March 2005.
[140] Emphasis added.
[141] *US—Upland Cotton* (Appellate Body), para. 324 *et seq.*, para. 336.

> to receive payments for producing covered crops, while less or no such payments are made to farmers who produce excluded crops, provides an incentive to switch from producing excluded crops to producing crops eligible for payments.[142]

Thus, the US payments for upland cotton farmers did not constitute, in the Appellate Body's view, de-coupled income support pursuant to paragraph 6 of Annex 2, and as a consequence did not benefit from the protection of the 'green box'.[143]

It remains unclear whether the EU's 'single payment scheme' would pass the sketched *Upland Cotton* standard.[144] Under that scheme, farmers are granted an annual income payment for the purpose of securing income stability, independently from what they produce.[145] However, they are only entitled to receive the payment if they set aside a portion of their land, maintain it in good agricultural and environmental condition, and comply with certain cross-compliance criteria, such as animal welfare and plant and animal health. If these conditions are not met, the payment is reduced.[146]

7. The Agreement on Agriculture's Export Competition Provisions

In many developed countries certain agricultural products cannot be produced at world market prices, due to the high costs of production (which are partly the consequence of high labour standards, but also follow from the need to compensate for climate or soil deficiencies). Under those circumstances, export subsidies enable the producers to successfully place their product in the world market, as the financial contribution by the state allows competitive prices. These prices may well be below their cost of production and even below the prices necessary for the survival of non-subsidized efficient producers. As a consequence, the supply of the product and, eventually, price pressure increase. Especially for developing countries—often very dependent on their agricultural sector—this may entail catastrophic consequences: Unable to compete with products sold at prices below their production costs, they may well be driven out of business. Their sometimes only comparative advantage would thus be nullified, as their agricultural sector could not compete with the public treasures of wealthy subsidizers, such as the EU, the United States, Japan, Norway, or Switzerland, to name the usual suspects.[147] It is somewhat ironic that the countries that promote most actively free trade when it comes to industrialized goods and services belong to the biggest sinners in the context of agricultural goods.

[142] Ibid. para. 331, emphasis in the original. [143] Ibid. para. 342.

[144] cf. the assessment by the European Parliament, Directorate General for Internal Policies—Policy Department B: Structural And Cohesion Policies—Agriculture And Rural Development, The Single Payment Scheme After 2013: New Approach-New Targets, Brussels 2010 (EIP/B/AGRI/IC/2009_038 March 2010); for the previous CAP see the comprehensive analysis by Michael Cardwell and Christopher Rodgers, 'Reforming the WTO Legal Order for Agricultural Trade: Issues for European Rural Policy in the Doha Round' (2006) *ICLQ* 55, 805–38, in particular 819 *et seq.*

[145] Joseph McMahon, *EU Agricultural Law* (Oxford University Press, 2007) 256.

[146] Alan Swinbank and Richard Tranter, 'Decoupling EU Farm Support', n. 133 at 52.

[147] Robson de Moura Fernandes, *Exploring Different Legal Approaches to Defining Agricultural Export Subsidies in the WTO Agreements*, n. 15 at 201, 202.

The AoA tries to undo or at least improve that situation. In a manner reminiscent of the disciplines on market access and domestic support, the amount of export subsidies is first identified, then scheduled, and, lastly, subjected to reduction commitments which amount to 36 per cent and 21 per cent, respectively.[148]

AoA Articles 3, 8, 9, and 10 set out the disciplines for export subsidies.[149] Contrary to the general subsidies regime pursuant to Article 3 of the SCM Agreement,[150] they remain legally permissible, provided that certain conditions[151] are met. First, members have to list in their schedules all export subsidies separately for each agricultural product. Secondly, they may only use export subsidies of the type listed in AoA Article 9.1. Finally, members may not exceed the commitments they made with regard to both quality and quantity of the scheduled subsidies. With regard to the latter requirement, the Appellate Body spelled out in *US—FSC*:

> As regards *scheduled* products, when the specific reduction commitment levels have been reached, the *limited authorization* to provide export subsidies as listed in Article 9.1 is transformed, effectively, into a *prohibition* against the provision of those subsidies.[152]

In addition, AoA Article 8 states the members' obligation not to use any subsidy that is not in conformity with the AoA, i.e., prohibiting any support that is either not indicated in the schedule or is exceeding the commitment level.[153] It is noteworthy that the *lex generalis* of Article 3 of the SCM Agreement prohibits *all* export subsidies, unless they are permitted by the AoA.

7.1 Definition of export subsidies

According to AoA Article 1(e) all subsidies contingent upon export performance are considered 'export subsidies' for the purpose of the AoA. But the Agreement does not specify the meaning of 'contingent upon export performance'. The same expression is, however, used in Article 3.1(a) of the SCM Agreement.[154] Pursuant to *EC—Large*

[148] AoA Art. 9.1(b)(iv).

[149] GATT Art. XVI:3 allowed export subsidies for primary goods.

[150] cf. the wording of Art. 3 of the SCM Agreement: '3.1 *Except as provided in the Agreement on Agriculture* [emphasis added], the following subsidies, within the meaning of Article 1, shall be prohibited: (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I; (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.'

[151] Pursuant to AoA Art. 3.3, a 'Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule.' The Appellate Body has emphasized the importance of the dual benchmark of budgetary outlay and quantity commitments; in its view, an obligation regarding 'budgetary outlay alone provides little predictability on export quantities, while a commitment on quantity alone could lead to subsidized exports taking place that would otherwise not have taken place but for the budgetary support'; *EC—Export Subsidies on Sugar* (Appellate Body), para. 197.

[152] *US—FSC* (Appellate Body), para. 152 (emphasis in the original).

[153] cf. *EC—Export Subsidies on Sugar* (Appellate Body), para. 209 *et seq.*

[154] The Panel in *US—FSC* notes that the definition of subsidy in the SCM Agreement is not necessarily directly applicable to the AoA and may have a different meaning in the AoA. As a general matter, 'however, and subject to any provision of the Agreement on Agriculture under which the contrary is to be inferred, we

Civil Aircraft, a subsidy must be 'geared to the promotion of exports' in order to be a prohibited export subsidy: This is the case, according to the Appellate Body, 'when the subsidy is granted so as to provide an incentive to the recipient to export in a way that is not simply reflective of the conditions of supply and demand in the domestic and export markets undistorted by the granting of the subsidy'.[155]

Both AoA and the SCM Agreement deal with subsidies and countervailing measures (in the broadest sense). As Article 3.1 of the SCM Agreement prescribes that export subsidies are prohibited except as provided otherwise in the AoA, it would seem advisable to start an analysis with the pertinent AoA provisions.[156] However, the SCM Agreement should be used for guidance in interpreting AoA provisions when appropriate, as rightly confirmed by the Appellate Body in *US—Upland Cotton*.[157] Thus, they are not mutually exclusive per se; rather, their joint legal existence mirrors the remaining specialty of agricultural trade in the WTO system.

In its Article 9.1, the AoA lists six different kinds of export subsidies that have to be reduced:

(a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance;
(b) the sale or disposal for export by governments or their agencies of non-commercial stocks of agricultural products at a price lower than the comparable price charged for the like product to buyers in the domestic market;
(c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived;
(d) the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight;
(e) internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments;
(f) subsidies on agricultural products contingent on their incorporation in exported products.

consider that a measure which represents a subsidy within the meaning of the SCM Agreement will also be a subsidy within the meaning of the Agreement on Agriculture'; *US—FSC* (Panel), para. 7.150. In a footnote the Panel clarifies that 'a measure which is listed as an export subsidy in Article 9.1 of the Agreement on Agriculture is an export subsidy for the purposes of the Agreement on Agriculture independently of the definition of subsidy in the SCM Agreement'; *US—FSC* (Panel), fn. 702.

[155] *EC and Certain Member States—Large Civil Aircraft* (Appellate Body), paras. 1046, 1050.

[156] *Canada—Dairy (Article 21.5—New Zealand and US)* (Appellate Body), para. 123.

[157] *US—Upland Cotton* (Appellate Body), para. 571; in the same vein, some authors suggest that the concepts of agricultural export subsidies as listed in Art. 9.1 are more or less the 'agricultural version of the more generic concept of export subsidies as understood and illustrated under the SCM Agreement': Melaku Geboye Desta, *The Law of International Trade in Agricultural Products*, n. 67 at 220.

The wording of the provision leaves no doubt that the listed practices are, without any need for further examination, export subsidies. Thus, absent exceptional circumstances, a complainant would not need to show a benefit for the recipient.[158] In the following, we shall briefly have a closer look at these prototypical examples of agricultural export subsidies.

7.2 The export subsidies prototypes pursuant to Article 9.1

7.2.1 'Direct subsidies'

Direct export subsidies, the prototypical type of export subsidies listed in AoA Article 9.1, include financial transactions or payments in kind provided by a government or their agencies to a firm, an industry, to producers of an agricultural product, to the cooperatives or associations of such producers, or to a marketing board.

In *Canada—Dairy*,[159] the United States challenged a Canadian dual price scheme as being inconsistent with AoA Articles 9.1 and 3.8. Canada determined its milk price with a view to the end-use of the milk. Exporters were required to obtain a permit which allowed them to receive milk from the producer at a lower price. Milk used for domestically marketed products was only available at a higher price. As exporters paid less for the milk, the Panel concluded that the provision of the milk at a price below the normal price was a payment in kind.[160] The Appellate Body disagreed with the Panel's assumption that a payment in kind constituted automatically a direct subsidy.[161] In the Appellate Body's opinion, it would have been necessary to determine whether the transfer of the payment in kind involved the transfer of an economic value and whether the recipient had to give something in return.[162] Unfortunately, the Appellate Body found it unnecessary to determine, whether the dual price system was a direct subsidy that appeared as a payment in kind,[163] as it accepted the Panel's determination that the measure in question had been captured by Article 9.1(c).[164]

Pursuant to AoA Article 9.1(a), the export subsidy is defined by its being paid 'contingent upon export performance.' The meaning of this criterion was addressed in *US—Upland Cotton*.[165] There, the United States had made a 'user marketing payment' available for all users and exporters of upland cotton, provided they purchased upland cotton within a week following a four-week period in which the marketing price for upland cotton delivered to Northern Europe exceeded the Northern European benchmark price. The parties agreed that these payments constituted direct subsidies. However, they disagreed as to whether they were export subsidies

[158] *EC—Sugar Subsidies* (Appellate Body), para. 269.

[159] *Canada—Dairy* (Panel), para. 7.35; cf. Merit Janow and Robert Staiger, 'Canada—Dairy: Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products' (2004) *World Trade Review* 3, 277–315, in particular 302 *et seq.*

[160] *Canada—Dairy* (Panel), paras. 7.44–7.45.

[161] *Canada—Dairy* (Appellate Body), para. 88.

[162] Ibid. paras. 87–8.

[163] Ibid. para. 92.

[164] Ibid.

[165] cf. William J. Davey and André Sapir, 'United States—Subsidies on Upland Cotton—Recourse to Article 21.5 by Brazil, WT/DS267/AB/RW (2 June 2008)' (2012) *World Trade Review* 9, 181.

contingent on export performance; unsurprisingly, the United States highlighted that payments were available for domestic users and exports alike.[166]

The Appellate Body agreed with the Panels to be informed by the SCM Agreement and the pertinent Appellate Body jurisprudence for interpreting the criterion 'contingent upon export performance':

> Although an export subsidy granted to agricultural products must be examined, in the first place, under the *Agreement on Agriculture*, we find it appropriate, as has the Appellate Body in previous disputes, to rely on the *SCM Agreement* for guidance in interpreting provisions of the *Agreement on Agriculture*. Thus, we consider the export-contingency requirement in Article 1(e) of the *Agreement on Agriculture* having regard to that same requirement contained in Article 3.1(a) of the *SCM Agreement*.[167]

In accordance with its report in *Canada—Aircraft*, the Appellate Body interpreted 'contingent upon export performance' as a conditional and dependent relationship between the export and the subsidy.[168] The export subsidy must be 'tied' to the export performance.[169] The regulation did apply to both domestic users and exporters; however, whereas *domestic users* had to show that they used the cotton in the domestic market, exporters had to show that they export the cotton. The obvious contingency upon export performance for the latter of the two groups is not affected by the availability of the subsidy for another group.[170]

The subsidy must be provided by a government or their agencies. In *Canada Dairy*, the Panel had to discuss whether this condition was fulfilled since neither the Canadian government nor their agencies sold milk to exporters and thus, no governmental fund was involved. The Panel did not limit the term 'provided by' to a strict financial contribution. Any involvement of government agencies in making available the benefit is enough. There was no need for the government to be directly involved; it sufficed that the bodies acting did so under authority delegated by the government.[171]

7.2.2 Sale or disposal for exports by governments or their agencies

The sale or disposal for export by governments of non-commercial stocks of agricultural products at a price below domestic level is equally subject to the obligation of reduction pursuant to AoA Article 9.1(b), as it represents a commercial advantage not available under market conditions.

7.2.3 Payments on export financed by virtue of governmental action

Under AoA Article 9.1(c), payments on exports of agricultural products that are financed by virtue of governmental action are prohibited. It is not necessary that the payments are charged on the public account and actually paid by the government.

[166] *US—Upland Cotton* (Appellate Body), para. 564.
[167] Ibid. para. 571 (emphasis in the original). [168] Ibid. para. 572.
[169] Ibid. [170] Ibid. para. 578.
[171] *Canada—Dairy* (Panel), paras. 7.63–7.86, confirmed in part by the *Canada—Dairy* (Appellate Body), para. 192.

Whereas Article 9.1(a) explicitly mentions payments in kind, Article 9.1(c) simply mentions payments. However, the context of AoA Article 9.1(c) supports

> a reading of the word "payments" that embraces "payments-in-kind".... *[N]one* of the export subsidies listed in Article 9.1 is restricted to grants made solely in money form and several expressly involve subsidies granted in a form other than money. Under Article 9.1(a), "payments-in-kind" are specifically included as a form of "direct subsidies". Similarly, under Article 9.1(b), the export subsidy identified may involve the disposal of agricultural goods *at less than domestic price*. Under Article 9.1(e), the provision of transport services for export shipments at *prices lower than the price charged for domestic shipments* is also an export subsidy.[172]

The payment has to be made *upon* exportation. According to the Panel in *Canada—Dairy*, this requirement is met when the payment is contingent on the exportation of the agricultural product.[173]

The question whether financing in the form of cross-subsidization constitutes an export subsidy within the meaning of AoA Article 9.1(c) was addressed in *EC—Sugar Subsidy*.[174] The EC had maintained a quota system according to which sugar in quotas A and B was eligible for domestic support and export refunds, however, only up to a maximum quantity in a specific marketing year. Any sugar in excess of these quotas was called 'C sugar'. 'C sugar' was either to be exported *or* to be transferred for the next marketing year as part of the A or B quota. It was, however, not permitted to be marketed on the domestic EC market. Producers usually chose the first option, and sold 'C sugar' below world market prices and even below production costs.[175] Brazil, Australia, and Thailand claimed that 'C sugar' benefited from export subsidies within the meaning of AoA Article 9.1(c) and that these subsidies were granted in excess of EC commitments, thus violating AoA Articles 3.3 and 8. They claimed that due to the domestic support and the export refunds, producers of 'A sugar' and 'B sugar' were capable of taking small losses when selling the sugar at very low prices. This, however, was viewed by the EC as an internal allocation of the producers' finances, not attributable to the EC.[176] In particular, it was claimed that there was no payment by the EC, as no economic resources had been transferred by the EC to producers with regard to 'C sugar'.[177]

The Appellate Body rejected this argument as too formalistic:[178] Recalling the findings in *Canada—Dairy* that a payment under AoA Article 9.1(c) does not

[172] *Canada—Dairy* (Appellate Body), para. 109 (emphasis in the original); see also ibid. para. 113: 'In our view, the provision of milk at discounted prices to processors for export under Special Classes 5(d) and 5(e) constitutes "payments", in a form other than money, within the meaning of Article 9.1(c). If goods or services are supplied to an enterprise, or a group of enterprises, at reduced rates (that is, at below market-rates), "payments" are, in effect, made to the recipient of the portion of the price that is not charged. Instead of receiving a monetary payment equal to the revenue foregone, the recipient is paid in the form of goods or services. But, as far as the recipient is concerned, the economic value of the transfer is precisely the same.'

[173] *Canada—Dairy* (Panel), para. 7.90.

[174] cf. the case analysis by Bernard Hoekman and Robert Howse, 'EC—Sugar' (2008) *World Trade Review* 7, 149.

[175] *EC—Sugar Subsidies* (Panel), para. 7.301.

[176] *EC—Sugar Subsidies* (Appellate Body), para. 29.

[177] Ibid.

[178] Ibid. para. 265.

require a specific form, the Appellate Body affirmed the finding that the sale of 'C sugar' at prices below production costs had only been sustainable as a consequence of financing by *some* economic resource.[179] Thus, it made no difference, if the transfer took place from an 'A sugar' producer to a 'C sugar' producer, or rather, if the same producer reallocated the resources received for 'A sugar' to the production of 'C sugar'.

Focusing more on effect than form, the Appellate Body recognized that domestic subsidies may 'spill over' and thus benefit export production, as agricultural products tend to grow regardless of their targeted market. However,

> it would erode the distinction between the domestic support and export subsidies disciplines of the Agreement on Agriculture if WTO-consistent domestic support measures were automatically characterized as export subsidies because they produced spill-over economic benefits for export production.[180]

The requirement 'by virtue of government action' arose in *Canada—Dairy*. The broad term 'government action' would seem to indicate that the full range of actions which are enshrined in the nature of governments' authorities are covered, such as the power to regulate, control, supervise, and conduct the behaviour of individuals.[181] However, Canada claimed that the sale of milk at a lower price was not a government action because the marketing board, whose members happened to be producers, negotiated the prices with the producers and then offered them to the exporters.[182] The Appellate Body recognized the difficulty

> to define in the abstract the precise character of the required link between the governmental action and the financing of the payments, particularly where payments-in-kind are at issue. Governments are constantly engaged in regulation of different kinds in pursuit of a variety of objectives. For instance, we can envisage that governmental action might establish a regulatory framework merely enabling a third person freely to make and finance "payments".... [T]here must be a tighter nexus between the mechanism or process by which the payments are *financed*, even if by a third person, and governmental action.[183] In our opinion, the existence of such a demonstrable link must be identified on a case-by-case basis, taking account of the particular governmental action at issue and its effects on payments made by a third person.[184]

Thus, a complainant has to demonstrate that a payment is financed by government action. This does not require direct payment or funding. However,

[179] *Canada—Dairy* (Appellate Body), para. 107.
[180] *Canada—Dairy (Article 21.5—New Zealand and US)* (Appellate Body), para. 90.
[181] *Canada—Dairy (Article 21.5—New Zealand and US I*) (Appellate Body), para. 112.
[182] *Canada—Dairy (Article 21.5—New Zealand and US I*) (Appellate Body), paras. 100–5.
[183] Where 'payments' *do* involve a 'charge on the public account', the link between the financing of the payments and governmental action is clearly less difficult to establish.
[184] *Canada—Dairy (Article 21.5—New Zealand and US I*) (Appellate Body), para. 115 (emphasis in the original).

> if government does not fund the payments itself, it must play a sufficiently important part in the process by which a private party funds "payments", such that the requisite nexus exists between "governmental action" and "financing".[185]

In *Canada—Dairy*, both the Panel and the Appellate Body assumed that this link existed due to the decisive role the government played in the Canadian dual pricing system, as it controlled all aspects of milk supply and sale.[186] Similarly, in *EC—Sugar Subsidies*, the resources paid for the sale of 'A and B sugar' made it possible to sell the 'C sugar' at the low price that created disaster for the competition. The EC sugar regime sets a tight framework for the production of sugar and its sale, which is controlled and supervised by the EC's Sugar Management Committee. 'C sugar' producers are fined, if they try to sell their sugar in the domestic market. Hence, a tight nexus between the government action and the financing was assumed, satisfying the Appellate Body's requirement for a demonstrable link between the governmental action and the financed payments.

7.2.4 Subsidies to reduce marketing costs

Pursuant to AoA Article 9.1(d), all payments for the marketing exports of agricultural products had to be reduced. Handling, upgrading, processing costs, and costs of international transport and freight are examples of covered marketing costs. All these costs occur as part of and during the sale of a product, whereas general business costs are not linked specifically to placing the product on a market.[187] In *US—FSC*, the Appellate Body refused to view an exemption of taxation for general costs[188] as a covered measure, because AoA Article 9.1(d) only addresses costs that relate to *specific* marketing performances rather than general costs of doing business.[189]

7.2.5 Transport charges for export shipments more favourable than for domestic shipments

AoA Article 9.1(e) disciplines government activities that favour transport charges for export shipments compared to domestic shipments.

7.2.6 Subsidies on agricultural product contingent on their incorporation in exported products

AoA Article 9.1(f) covers so-called 'upstream subsidies',[190] i.e. subsidies that depend on the incorporation of the subsidized agricultural product into an exported product.

[185] *Canada—Dairy (Article 21.5—New Zealand and US II)* (Appellate Body), para. 133.
[186] Ibid. para. 146. [187] *US—FSC* (Appellate Body), para. 130.
[188] Ibid. paras. 6–11; *US—FSC* (Panel), para. 2.4.
[189] *US—FSC* (Appellate Body), para. 131.
[190] Melaku Geboye Desta, *The Law of International Trade in Agricultural Products*, n. 67 at 223.

7.3 Prohibition of circumvention

AoA Article 10.1 prohibits the use of export subsidies, which are *not* listed in AoA Article 9.1 but would have a similar effect:

> Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments.

For AoA Article 10 to apply, it is sufficient that the measure is applied in a manner that threatens to lead to circumventions.[191] The varying disciplines for export subsidies make the determination of whether there is indeed prohibited circumvention dependent on a case-by-case analysis. In *US—FSC*, the starting point was the prohibition, pursuant to AoA Article 3.3, of granting export subsidies for unscheduled agricultural products. If a member practises a transfer of economic resources contrary to AoA Article 3.3 by a method not listed in AoA Article 9.1, it would circumvent the prohibition. Whereas transferring an economic value through tax exemption threatens to circumvent the prohibition of AoA Article 3.3,[192] *scheduled goods* may legally benefit from export subsidies listed in AoA Article 9.1 as long as the amount remains within the bounds established in the schedules. The US income tax relief in question was unlimited, and granted to both scheduled and non-scheduled products. Therefore, an agricultural product could benefit from the economic value of the tax exemption despite the fact that the maximum amount of subsidies permissible pursuant to AoA Article 9.1 had been reached. The Appellate Body concluded, therefore, that the tax exemption for foreign sales corporations was in breach of AoA Article 10.1.[193]

In *US—Upland Cotton*, the Appellate Body had to address whether certain US export guarantee programmes constituted an export subsidy within the meaning of AoA Article 10.1. Under the so-called 'General Sales Manager 102' programme, producers exporting their agricultural products on credit terms received a repayment guarantee. If the foreign bank failed to make a payment, the (fully government-owned) Commodity Credit Corporation covered this failure.[194] Upland cotton was a non-scheduled agricultural product and export credit guarantees are not listed in AoA Article 9.1.

AoA Article 10.2 contains an obligation for members to commence actions to develop disciplines on certain forms of export support measures:

> Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

The United States claimed that it had understood this work programme as an implied exemption from the normal disciplines of the preceding paragraph. Indeed, 'export

[191] *US—FSC* (Appellate Body), para. 148. [192] Ibid. para. 149.
[193] Ibid. para. 150. [194] *US—Upland Cotton* (Panel), para. 7.242.

credits, export credit guarantees or insurance programmes' are very common state measures to support members' exports. The mandate to develop disciplines for these common practices and the omission of them from the list of export subsidies in AoA Article 9.1 supports the view that the US negotiators understood the AoA's disciplines to *not yet apply* to these forms of state aids.

While this point of view was accepted by one of the Appellate Body members in a rather rare example of a dissenting opinion,[195] it was unequivocally rejected by the majority:

> Although Article 10.2 commits WTO Members to work toward the development of internationally agreed disciplines on export credit guarantees, export credits and insurance programs, it is in Article 10.1 that we find the disciplines that currently apply to export subsidies not listed in Article 9.1. A plain reading of Article 10.1 indicates that the only export subsidies that are excluded from its scope are those "listed in paragraph 1 of Article 9". . . . Thus, to the extent that an export credit guarantee meets the definition of an "export subsidy" under the *Agreement on Agriculture*, it would be covered by Article 10.1.[196]

In the majority's view, the language used in AoA Article 10.2 merely suggests that the provisions that apply to these measures should be looked at for redesign and refinement, for example, by developing a precise definition of export guarantee schemes that are per se prohibited.[197]

> The United States submits that Article 10.2 contributes to the prevention of circumvention because it commits WTO Members to work toward the development of internationally agreed disciplines and to provide export credit guarantees, export credits and insurance programs only in conformity with these disciplines once an agreement has been reached. . . . The necessary implication of the United States' interpretation of Article 10.2 is that, until WTO Members reach an agreement on international disciplines, export credit guarantees, export credits and insurance programs are subject to no disciplines *at all*. In other words, under the United States' interpretation, WTO Members are free to "circumvent" their export subsidy commitments through the use of export credit guarantees, export credits and insurance programs until internationally agreed disciplines are developed, whenever that may be. We find it difficult to believe that the negotiators would not have been aware of and did not seek to address the potential that subsidized export credit guarantees, export credits and insurance programs could be used to circumvent a WTO Member's export subsidy reduction commitments. Indeed, such an interpretation would *undermine* the objective of preventing circumvention of export subsidy commitments, which is central to the *Agreement on Agriculture*.

However, in contrast to the Panel's view the export subsidies listed in Annex I of the SCM Agreement, the Appellate Body found that those measures do not necessarily constitute an export subsidy for the purposes of the AoA.[198] Rather, it is up to the complaining party to show that the measure constitutes an export subsidy and is

[195] *US—Upland Cotton* (Appellate Body), paras. 631–41. [196] Ibid. para. 615.
[197] Ibid. para. 611; see the following excerpt at ibid. para. 617. [198] Ibid. para. 626.

applied in a manner that circumvents the commitments.[199] In this context, the provision of AoA Article 10.3 merits mentioning, which reads:

> Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question

With regard to this provision, the Appellate Body stated in *Canada—Dairy*:

> The significance of Article 10.3 is that, where a Member exports an agricultural product in quantities that exceed its quantity commitment level, that Member will be treated as if it has granted WTO-*inconsistent* export subsidies, for the excess quantities, unless the Member presents adequate evidence to "establish the contrary." . . . Article 10.3 thus acts as an incentive to Members to ensure that they are in a position to demonstrate compliance with their quantity commitments under Articles 3.3 and 8 of the *Agreement on Agriculture*.[200]

This reversal of the usual rules on the burden of proof obliges the European Communities to 'bear the consequences of any doubts concerning the evidence of export subsidization'.[201] The ruling of the Appellate Body in *US—Upland Cotton* has created a somewhat vexing situation for the United States. The negotiation history shows that export credits had always been an issue.[202] Not the least upon US insistence, export credit schemes were excluded from the list of export subsidies in AoA Article 9.1.[203] If that had not happened, the use of export credits would have remained permissible, albeit limited by the commitments. As a consequence of Appellate Body jurisprudence, export credits are now completely prohibited, if they amount to export subsidies. While this may be a positive result in substance, one wonders whether the Appellate Body paid sufficient attention to the purpose of any treaty interpretation, that is, to establish the mutual understanding of the contracting parties of the treaty obligations entered into.

7.4 Reduction commitments

The export subsidy commitments are reflected in the member's schedule: If a member indicates commitment levels by budgetary outlay, it needs to indicate the maximum amount of such subsidies for each agricultural product or product group per year.[204] Export quantities reduction commitments had to identify the maximum quantity of each agricultural product receiving a subsidy; members agreed to reduce their spending on export subsidies by 36 per cent (the reference period being 1986 to 1990) and to

[199] Ibid.
[200] *Canada—Dairy (Article 21.5—New Zealand and US II)* (Appellate Body), para. 74.
[201] Ibid.
[202] Dominic Coppens, 'WTO Disciplines on Export Credit Support for Agricultural Products in the Wake of the US–Upland Cotton Case and the Doha Round Negotiations' (2010) *Journal of World Trade* 44, 349, 358.
[203] Marc Benitah, 'U.S. Agricultural Export Credits after the WTO Cotton Ruling: The Law of Unintended Consequences' (2005) *The Estey Centre Journal of International Law and Trade Policy* 6, 107, 108.
[204] AoA Art. 9.2(a).

reduce the quantities receiving export subsidies by 21 per cent.[205] Developing countries had ten years to reduce their budgetary outlay by 24 per cent and quantities by 14 per cent,[206] whereas least developed countries were exempted from reduction commitments by virtue of AoA Article 15.2.

Currently, twenty-five members have scheduled reduction commitments[207] and are therefore allowed to continue with their practices, albeit only in the moderated fashion agreed upon at the conclusion of the Uruguay Round. For all other members, export subsidies are prohibited. This is another example for the approximation of the regime for agricultural goods has approached the general rules on trade in goods.

7.5 Export restrictions

As indicated above, the AoA focuses on disciplining the developed world market access restrictions on one hand and, on the other hand, unfair exports policies. Whereas members' policies with regard to limiting agricultural imports are markedly restricted, there is very little regulation of export restrictions. This is, of course, not a phenomenon limited to agriculture: whereas import tariffs are fairly comprehensively regulated through binding pertinent commitments, very few export tariffs are bound. Interestingly, the most heavily regulated members are 'newcomers' who had to accept in their Protocols of Accession disciplines surpassing the ones in the WTO agreements. Having said that, GATT Article XI prohibits in principle any quantitative restriction, both for imports and exports. However, Article XI:2 allows

(*a*) Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting [Member];
(*b*) Import and export prohibitions or restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade;...

GATT Article XI:2 limits somewhat the policy space established by GATT Article XI:1, but that does not change the thrust of this provision: the GATT disciplines with regard to agricultural export restrictions are very soft indeed.[208] AoA Article 12 does not much alter that status quo:

1. Where any Member institutes any new export prohibition or restriction on foodstuffs in accordance with paragraph 2(a) of Article XI of GATT 1994, the Member shall observe the following provisions:
   (a) the Member instituting the export prohibition or restriction shall give due consideration to the effects of such prohibition or restriction on importing Members' food security;

[205] Modalities Agreement, MTN.GNG/MA/W/24, para. 11. [206] Ibid. para. 15.
[207] Committee on Agriculture, *Export Subsidies, Export Credits, Export Credit Guarantees or Insurance Programmes, International Food Aid and Agricultural Exporting State Trading Enterprises—Background Document by the Secretariat*, WTO Doc. G/AG/W/125/Rev. 2 (19 May 2015); WTO Doc. G/AG/W/125/Rev. 2/Add. 1 and WTO Doc. G/AG/W/125/Rev. 2/Add. 2 (19 May 2015).
[208] AoA Art. 12.

(b) before any Member institutes an export prohibition or restriction, it shall give notice in writing, as far in advance as practicable, to the Committee on Agriculture . . . , and shall consult, upon request, with any other Member having a substantial interest as an importer with respect to any matter related to the measure in question. . . .

2. The provisions of this Article shall not apply to any developing country Member, unless the measure is taken by a developing country Member which is a net-food exporter of the specific foodstuff concerned.

Clearly, this is a fair reflection of the status quo until (and including) the Uruguay Round. Whereas the food shortages during and immediately after the Second World War explain the existence of the safety valve of Article XI:2, the thrust of agricultural negotiations was the conflict between Southern agricultural exporters and (most) OECD countries which shielded their domestic industry from import competition and used export subsidies to neutralize their surpluses, thus, thwarting export opportunities of developing countries in third markets. While it would be an inaccurate exaggeration to describe the AoA as a capitulation of the North, it was shaped by the interest of the big agricultural exporters (for instance Australia, Brazil, and New Zealand) and much less by the EU or even the United States. In fact, it would not be a gross caricature of the negotiation dynamics to state that accommodating the developing world in agriculture and textiles was the developed world's currency to get their developing partner to accept the overall arrangement that is at the basis of the WTO Agreement.

Since then, the world of agriculture has changed: for reasons mentioned above, the massive surplus of agricultural products has vanished and given place to a higher structural demand (due to, inter alia, continuing population growth, wealth increases in non-OECD countries, and the increasing importance of biofuels) and structurally stagnant or diminishing production (due, inter alia, to climate change). In 2007/08 and again in 2010/11 the new situation led to food price hikes that caused panic reactions in developing countries. As a consequence, many of these countries used price stabilization programmes,[209] which included selling grain from publicly held stocks,[210] targeted programmes for the poor, and temporary abolition of sales taxes on foodstuffs. What is noteworthy in our context is the use of export restrictions and import facilitations. It seems that approximately a third of all WTO members used export restrictions,[211]

[209] cf. Mulat Demeke, Guendalina Pangrazio, and Materne Maetz, 'Country Responses to the Food Security Crisis: Nature and Preliminary Implications of the Policies Pursued', Food and Agriculture Organization of the United Nations Initiative on Soaring Food Prices (Rome, 2009); Olivier de Schutter, 'The World Trade Organization and the Post-Global Food Crisis Agenda. Putting Food Security First in the International Trade System, UN Special Rapporteur on the right to Food', Briefing Note 4, November 2011.

[210] cf. Darryl Jones and Andrzej Kwiecinski, 'Policy Responses in Emerging Economies to International Agricultural Commodity Price Surges', OECD Food, Agriculture and Fisheries Papers, No. 34 (OECD Publishing, 2010), <http://dx.doi.org/10.1787/5km6c61fv40w-en>.

[211] Giovanni Anania, 'Agricultural Export Restrictions and the WTO—What Options do Policy-Makers Have for Promoting Food Security?' ICTSD Issue paper 50, 2013, 12 gives the following examples: Argentina (wheat, soybeans, and sunflower seeds), Cambodia (rice), China (rice, wheat maize, and flour), Egypt (rice), India (rice and wheat), Kazakhstan (wheat, soybeans, and sunflower seeds), Pakistan (rice and wheat), Russia (wheat, maize, flour, and rapeseed), Ukraine (wheat, maize, and barley), and Vietnam (rice).

mostly a mix of pertinent measures. Since then, the term 'food security' has become an integral part of the WTO negotiations. While export restrictions are mostly used by countries like India with a significant agricultural sector that this country wishes to protect from outside competition, countries like Japan, which are very dependent on the importation of foodstuffs, want export restriction to be subjected to much the same development as has been the case with regard to import restrictions: more substantial disciplines and transparent communication.

8. Review and Remedies

8.1 Committee on Agriculture

AoA Article 17 establishes a Committee on Agriculture whose main task consisted of the review of the members' implementation of their commitments, which were notified, pursuant to AoA Article 18.3, comprehensively in 1995.[212] AoA Article 18.3 requires the members to notify 'promptly' all modifications of existing measures or the introduction of new domestic support measures, regardless which exemption the member claims.[213] In addition, members have to notify the Committee comprehensively at the end of each calendar or marketing year;[214] least developed countries have to submit their documentation only every two years.[215]

The purpose of this review mechanism is to provide an opportunity for the members to check whether they are in line with the commitments[216] and to allow other members to bring measures, which should have been notified, to the attention of the Committee.[217] As such, it is a useful tool for facilitating transparency in the agricultural trading system. However, it is not a means to enforce the obligations under the AoA; rather, AoA Article 19 refers disputes under the AoA to the regular dispute settlement procedure.

8.2 The 'Peace Clause': history

The AoA establishes a complex matrix of special substantial provisions. In the same vein, it sets up special procedural constellations: An example is AoA Article 13, also known in WTO parlance as the 'Peace Clause'. This provision limited the possibility to challenge subsidies for agricultural products under the WTO dispute settlement mechanism until the end of the implementation period in 2003 (cf. AoA Article 1(f)).

The 'Peace Clause' was essentially a compromise concluded between the United States and the EC on some of their differences concerning agriculture. Part and parcel of that deal was the 'Peace Clause', which was of importance to the EC as it wanted to insulate its modified 'Common Agricultural Policy' (CAP) from a legal challenge under

[212] Melaku Geboye Desta, *The Law of International Trade in Agricultural Products*, n. 67 at 422; WTO Committee on Agriculture, *Notification Requirements and Formats*, G/AG/2, 30 June 1995.
[213] Ibid. 2–5. [214] Ibid. 5–10. [215] Ibid. 12–21.
[216] AoA Art. 18.6. [217] AoA Art. 18.7.

the envisaged (and untested) WTO dispute settlement mechanism.[218] Despite that sunset date, the Peace Clause was invoked in disputes after 2004 in *Mexico—Olive Oil* and *US—Upland Cotton*. The *Mexico—Olive Oil* Panel report, adopted in 2008, dealt with Mexican investigations that started during the implementation period.[219] With this reasoning, the Panel avoided a discussion of when exactly the implementation period expired.[220] In *Upland Cotton*, the Panel accepted the applicability of AoA Article 13 due to the initiation date of the dispute settlement procedure taking place during the nine-year implementation period.[221]

8.3 Remedies after the expiry of the 'Peace Clause'

Since the expiry of the 'Peace Clause' the question of the relationship between the AoA and other agreements under Annex 1A covering trade in goods—briefly discussed above—has gained importance.

Pursuant to AoA Article 21.1, the AoA takes precedence over other agreements if it contains 'specific provisions dealing specifically with the same matter'.[222] Thus, the question whether subsidies covered by the AoA are subject to challenges under other agreements, especially the SCM Agreement and GATT Articles VI and XVI depends on what the AoA provides for these issues. In any event, the AoA does not contain provisions on remedies: thus, recourse to the other agreements of Annex 1A would seem appropriate.

According to its Preamble, the AoA is supposed to constitute a 'basis for initiating a process of reform for trade in agriculture' with long-term objectives such as 'a fair and market-oriented agricultural trading system' and the prevention and correction of distortions in the agricultural trading system. Thus, one could take the view that the whole agreement frames a reform process, which is not yet at its end; strict submission to the disciplines under the SCM Agreement would not be in line with the wish of the drafters. In that view, the 'Peace Clause' remains an essential part of the AoA.[223]

We are of the opinion that there are no limitations regarding the applicability of trade remedy provisions. AoA Article 13 explicitly limits recourse to effective trade remedies only *temporarily*; accordingly, negotiators only intended to temporarily exempt agricultural subsidies from DSU complaints.[224] Once that exceptional

[218] David Morgan and Gavin Goh, 'Peace in Our Time? An Analysis of Article 13 of the Agreement on Agriculture' (2003) *Journal of World Trade* 37, 977, 979. One particularly thorny issue had been the *Oilseeds* dispute; see GATT Panel report, *European Economic Community—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, L/6627, adopted 25 January 1990, B.I.S.D. 37S/86.

[219] *Mexico—Olive Oil* (Panel), para. 7.54.

[220] Ibid. para. 7.53.

[221] *US—Upland Cotton* (Panel), paras. 7.340–7.345, 7.350; see also *US—Upland Cotton* (Appellate Body), para. 319 *et seq.*

[222] *EC—Bananas III* (Appellate Body), para. 155; see also Didier Chambovey, 'How the Expiry of the Peace Clause (Art.13 of the WTO Agreement on Agriculture) Might Alter Discipline on Agricultural Subsidies in the WTO Framework' (2002) *Journal of World Trade* 36, 305, 310.

[223] See Marc Benitah, *The Law of Subsidies under the GATT/WTO System* (Kluwer Law International, 2001) 18.

[224] David Morgan and Gavin Goh, 'Peace in Our Time?', n. 218 at 986.

temporary halt came to an end, the normal applicability of the remedies offered to aggrieved members by the SCM Agreement (unless otherwise determined by the AoA) kicked in.

9. Special Treatment of Developing Countries

AoA Articles 15 and 16 contain *general* 'special and differential treatment' (S&D) provisions benefiting developing and least developed countries. The latter provision refers specifically to the *Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net-Food-Importing Developing Countries* which is an integral part of the Marrakesh Agreement.[225] All operative pillars of the AoA contain *specific* 'special and differential treatment' provisions.

10. The Changing Interests in Agriculture and the Doha Round Negotiations

AoA Article 20 requires the members to launch negotiations to continue the reform process one year before the end of the implementation period, that is, by the end of 1999.[226] Talks began in early 2000, with agriculture always being one of the central topics.[227] In the Ministerial Declaration kicking off the Doha Round, members committed themselves to negotiate on

> substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support. We agree that special and differential treatment for developing countries shall be an integral part of all elements of the negotiations and shall be embodied in the schedules of concessions and commitments and as appropriate in the rules and disciplines to be negotiated, so as to be operationally effective and to enable developing countries to effectively take account of their development needs, including food security and rural development. We take note of the non-trade concerns reflected in the negotiating proposals submitted by Members and confirm that non-trade concerns will be taken into account in the negotiations as provided for in the Agreement on Agriculture.[228]

A framework for the negotiations was adopted at the General Council meeting in July 2004, following the talks in Cancún in 2003.[229] At the time of writing, the Doha Round

[225] Reprinted, inter alia, in <http://www.wto.org/english/docs_e/legal_e/35-dag.pdf>.

[226] The preparatory work saw high levels of participation by WTO members. In the twelve meetings held between 1997 and 1999, seventy-four papers from thirty-six members were discussed, which included thirteen papers from twenty-four developing countries. A summary of the meetings in the AIE process can be found in the 1999 Chairman's report to the Council for Trade in Goods in document G/L/322.

[227] Masayoshi Honma, 'Agricultural Issues in the Doha Development Agenda Negotiations' in A. Yanovich and J. Bohanes, eds., *The WTO in the Twenty-First Century* (Cambridge University Press, 2007) 328–40.

[228] *Doha Ministerial Declaration*, WT/MIN(01)/DEC/1, 20 November 2001, para. 13.

[229] *Decision Adopted by the General Council on 1 August 2004*, WT/L/579, 2 August 2004.

has been going on for more than fourteen years;[230] the so-called Bali package, concluded in December 2013, has, after renewed difficulties in 2014,[231] finally been the first tangible result with regard to agricultural trade.

Current agricultural negotiations are much more multi-polar today than used to be the case in prior Rounds. Old key players such as the United States and the EU have remained highly relevant. However, developing country giants such as Brazil and India have started playing a particularly influential role. While claiming to represent the developing world, their interests are quite separate from those of the LDCs and other 'normal' developing countries. Many of these have built coalitions, and so has everybody else,[232] forming flexible, partially overlapping alliances. Among the various coalitions some of the most active ones are: the *Cairns group* consisting of ninteeen WTO exporting members,[233] which are keen to achieve full liberalization of trade in agricultural products;[234] the *G-10 group* of heavily subsidizing members promoting a special treatment of agriculture claiming to advance non-trade concerns;[235] the *G-20* is a coalition aiming at ambitious reforms of the agricultural trade in developed countries but with flexibility to developing countries.[236] The *Cotton-4* group (of four West African countries) stands up for essential cuts in subsidies for cotton.[237] The *G-33*, also named *Friends of Special Products*, call for flexibility of developing countries to make limited market access commitments for agricultural products.[238]

The Doha Development Round is the longest negotiation round in the GATT/WTO history. Like its predecessors, the DDA is structured as a 'single undertaking' effort. Thus, success depends on agreements in all areas, such as non-agricultural market access, services, intellectual property rights, and dispute settlement.[239] However agriculture is, more than ever, crucial for a successful conclusion:

[230] Dilip Das, 'The Doha Round of Multilateral Trade Negotiations and Trade in Agriculture' (2006) *Journal of World Trade* 40, 259–90.

[231] On 31 July 2014, the deadline for implementing the Bali package ended without the necessary consensus amongst members; cf. WTO: 2014 News Items, 31 July 2014, Trade Negotiations Committee—Informal Meeting: Azevêdo: Members unable to bridge the gap on trade facilitation, <http://www.wto.org/english/news_e/news14_e/tnc_infstat_31jul14_e.htm>.

[232] WTO—Groups in Agricultural Negotiations, see: <http://www.wto.org/english/tratop_e/agric_e/negoti_groups_e.htm>.

[233] Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Pakistan, Paraguay, Peru, Philippines, South Africa, Thailand, and Uruguay.

[234] WTO—Groups in Agricultural Negotiations, n. 232.

[235] Members are Chinese Taipei, Iceland, Israel, Japan, Korea, Liechtenstein, Mauritius, Norway, and Switzerland. WTO—Groups in Agricultural Negotiations, n. 232.

[236] Members are Argentina, Bolivia, Brazil, Chile, China, Cuba, Ecuador, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Peru, Philippines, South Africa, Tanzania, Thailand, Uruguay, Venezuela, and Zimbabwe. WTO—Groups in Agricultural Negotiations, n. 232.

[237] Benin, Burkina Faso, Chad, and Mali, WTO—Groups in Agricultural Negotiations, n. 232.

[238] Members are Antigua and Barbuda, Barbados, Belize, Benin, Bolivia, Botswana, Côte d'Ivoire, China, Congo, Cuba, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, India, Indonesia, Jamaica, Kenya, Korea, Madagascar, Mauritius, Mongolia, Mozambique, Nicaragua, Nigeria, Pakistan, Panama, Peru, Philippines, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Senegal, Sri Lanka, Suriname, Tanzania, Trinidad and Tobago, Turkey, Uganda, Venezuela, Zambia, and Zimbabwe; WTO—Groups in Agricultural Negotiations, n. 232.

[239] Robert Wolfe, 'Sprinting during a Marathon: Why the WTO Ministerial Failed in July 2008' (2010) *Journal of World Trade* 44, 81, 92.

> [A]lthough it accounts for less than 10 per cent of world trade, it holds the key to unblocking and revitalizing the negotiations and ensuring substantive progress across the board.... Surely because 70% of the world poor live in rural areas and that negotiators when launching these talks agreed to frontload development. Not easy, of course, not the least because at the WTO one could say that there are two schools of thought on how the agriculture sector should be treated. Some countries believe that the agricultural sector is no different from other sectors of world trade and should be subjected to disciplines applied in these sectors, including the prohibition of subsidies to farmers. Others believe that agriculture is a distinct sector which governments should be able to support for a variety of reasons, including preserving family farming or the environment.[240]

The Doha Development Agenda made special and differential treatment integral throughout the negotiations, both in new commitments and in any new or revised rules and disciplines. It emphasizes that the outcome should be effective in practice and should enable developing countries to meet their development needs, in particular in food security[241] and rural development. The two latter aspects are also taken into account as non-trade concerns (as is environmental protection). The deadlines that had been set for the negotiations have all been missed so far. A new framework for the negotiations was adopted at the General Council meeting in July 2004, after talks at the Ministerial level in Cancún 2003.[242] With the advantage of hindsight, the following phases may be identified:

- 'Preparations for modalities' (March 2002–July 2003);
- 'Cancún and the framework phase' (August 2003–August 2004); and
- 'The modalities phase' (September 2004–onwards).[243]

10.1 The 2008 modalities

In 2008, members agreed on *draft* agricultural modalities (referred to here as the '2008 draft modalities').[244] Despite the fact that it is not more than a snapshot of where the discussions were in 2008,[245] it remains to this day a reference text.[246] At the time of writing, discussion is ongoing between WTO members as to whether the 2008 modalities should remain the starting point for future discussions, or whether there should be

[240] Speech delivered by the Director General of the WTO, Pascal Lamy, *The Doha Development Agenda: Sweet Dreams or Slip Slidin' Away*, International Institute of Economics, Washington DC, 17 February 2006.

[241] Thomas J. Schoenbaum, 'Fashioning a New Regime for Agricultural Trade: New Issues and the Global Food Crisis' (2011) *Journal of International Economic Law* 14, 593–611.

[242] Decision Adopted by the General Council on 1 August 2004, WT/L/579, 2 August 2004. For further reading see: Faizel Ismail, 'Mini-Symposium on Developing Countries in the Doha Round, A Development Perspective on the WTO July 2004 General Council Decision' (2005) *Journal of International Economic Law* 8, 377–404.

[243] For more information about the history of negotiations on agriculture, see TN/AG/6, December 2002; TN/AG/W/1, February 2003; TN/AG/W/1/Rev.1, March 2003; TN/AG/10, July 2003; TN/AG/W/1, February 2003; TN/AG/W/1/Rev.1, March 2003; TN/AG/10, July 2003.

[244] Revised Draft Modalities for Agriculture, TN/AG/W/4/Rev.4, 6 December 2008.

[245] Robert Wolfe, 'Sprinting during a Marathon', n. 239 at 92.

[246] Used, for example, in the Bali Decisions.

a completely fresh look at the situation. The United States is in favour of the latter position whilst most developing countries would prefer the former. The reason for this difference is, inter alia, that many developing countries now have support volumes comparable to those of the OECD countries.[247]

10.1.1 Market access

As the tariffs resulting from the Uruguay Round tariffication requirement were high, whereas the cuts remained moderate, members would undertake further cuts in tariffs for agricultural products.[248] Developed countries would cut their tariffs for all products subject to tariffs from 0 to 20 per cent by half (50 per cent). Tariffs between 20 and 50 per cent would have to be reduced by 57 per cent, tariffs between 50 and 75 per cent would have to be cut by 64 per cent; lastly, tariffs above 75 per cent would have to be cut by 70 per cent. The minimum average of all the tariff reductions was fixed at 54 per cent.

The 2008 draft modalities prescribe a special and differential treatment for developing countries, entailing lesser commitments.[249] The cuts in tariffs would be accompanied by two limitations:

(1) Members would be able to designate products as 'sensitive'; these 'sensitive products' would be subject to smaller cuts, but these limitations would have to be balanced by tariff quotas to ensure a minimum market access at lower tariff rates.[250] Developed countries would be able to designate up to 4 per cent of tariff lines for 'sensitive products', developing countries would be allowed one third more. Japan and Canada have declared strong reservations about these tariff reduction limitations.[251]
(2) Developing countries would be entitled to designate 'special products' for food security, livelihood security, and rural development reasons.[252] Up to 12 per cent of their tariff lines could be designated as special products and five of them would not have to be subject to tariff cuts at all. Similar provisions for 'special products' ought to be available for small vulnerable economies and recently accessed members.[253]

10.1.2 Special safeguards

The special safeguards (AoA Article 5) should no longer be invoked by developed country members after the seventh year of the implementation period. Developing countries should reduce the coverage of the safeguards: only 2.5 per cent of the tariff

[247] Agricultural Policy Monitoring and Evaluation 2013: OECD Countries And Emerging Economies, Paris, OECD 2013, 73 *et seq.*
[248] Revised Draft Modalities for Agriculture, para. 61.
[249] The cuts in each level would be two-thirds of the cut that the developed countries are obliged to make for tariff rates between 0 and 30 per cent.
[250] Revised Draft Modalities for Agriculture, paras. 71–83.
[251] cf. fn. to ibid. para. 71.
[252] Ibid. para. 129.
[253] Ibid. paras. 130–1.

lines may be protected with safeguards.[254] No agreement has been reached yet on the conditions allowing the developing countries to increase their tariffs in the event of an import surge or decline in the prices of commodities.

10.1.3 Export competition

AoA Article 10.2 encouraged members to work on disciplines for export credit, guarantees, and insurances. They reached an agreement in the Doha negotiations, which would explicitly prohibit the use of export credits and similar measures.[255] There is broad understanding and agreement about the related issues including export credit guarantees,[256] state-trading enterprises,[257] and international food aid.[258] In the Hong Kong Ministerial Conference, it was agreed that export subsidies and measures having equivalent effect, including export credits, be eliminated by 2013,[259] but this time frame was extended to 2016 for the developing countries.[260]

10.1.4 Domestic support

For further reduction of the spending on domestic support, a new benchmark has been proposed. Under the new rules, the basis for any reduction commitments would be the *overall trade-distorting domestic support*, called base OTDS, which is the sum of the final bound level as it is currently indicated in the members' schedules, *plus* 10 per cent of the average of the domestic production of the years 1995–2000, and *plus* the highest average of a notified blue box payment during the years 1995–2000.[261] For developing countries, 20 per cent of the average of the domestic production is included in the calculation and the respective base period may be either 1995–2000 or 1995–2004, as determined by the member.[262] The reduction is based on a tiered formula: For a base OTDS higher than US$60 billion, the reduction shall be 80 per cent. A 70 per cent reduction is required for a base OTDS greater than US$10 billion but less than or equal to US$60 billion. Finally, if the base OTDS is less than or equal to US$10 billion, it is to be reduced by 55 per cent. The reductions have to be made within five years for developed countries and eight years for developing countries. Net-food importing countries and developing countries with no final binding commitments are not required to undertake any reduction commitments.

The modalities provide for two different kinds of payments that are exempted from the total AMS calculation but account for the base OTDS. Direct payments under production limiting programmes and direct payments de-coupled from production fall within the 'blue box'. Additionally, the members have to respect product-specific limits when they provide spending within the 'blue box'. The various support measures

[254] Ibid. paras. 126–7. [255] Ibid. Annex J. [256] Ibid. para. 165.
[257] Ibid. para. 166. [258] Ibid. para. 167.
[259] The Hong Kong Ministerial Declaration (WT/MIN(05)/DEC), 22 December 2005, para. 6.
[260] Revised Draft Modalities for Agriculture, para. 155.
[261] Ibid. para. 1. [262] Ibid. para. 2.

allowed within the 'green box' remain in place but are modified. Special attention is given to the needs of developing countries, with a view to granting them more flexibility. For example, the possibility of granting financial support under the General Services paragraph in Annex 2 is enhanced by adding programmes to support rural development and rural livelihood security in developing countries. Also, developing countries contributing to farmers through insurance schemes can make payments available for the farmer, even if the loss is below the regular threshold of 30 per cent.[263] Another example can be found in Annex 2, paragraph 13 where payments under regional assistance programmes can be made by developing countries without designating a disadvantaged region as a contiguous geographical area.[264] There is also a broad consensus concerning the reduction of *de minimis* support of the developed countries from 5 per cent to 2.5 per cent of the total value of agricultural production.[265]

10.2 Efforts to save the Doha Round: the Bali package and beyond

Whereas the 2008 draft modalities remained that—a draft—due to the lack of an overall conclusion of the DDA, efforts to bring the Round to a successful conclusion continued. The then Director-General's proposal for an 'early-harvest' type of mini-packages failed to receive the support of the Eighth Ministerial Conference in 2011. However, it was taken up again by the newly elected Director-General Azevêdo, a former Brazilian Ambassador to the WTO, who declared the conclusion of a mini-package at the Ninth Ministerial Meeting in Bali to be the best chance for the WTO to stay relevant. On 7 December 2013, Ministers adopted the 'Bali Ministerial Declaration', which is built around four modules: Trade Facilitation, Agriculture, Cotton and Development, and LDC issues.[266] With regard to Agriculture, the Decision covers all three pillars of the AoA, including market access, domestic support, and export competition.

Tariff quotas, it will be recalled, facilitate market access by establishing for grandfathered market shares lower than the usually very high tariffs. Ministers agreed that measures should be taken to ensure a better use of tariff quotas by developing countries and to specify measures to render that administration more favourable for exporters.[267] Furthermore,

> Tariff quota administration of scheduled tariff quotas shall be deemed to be an instance of "import licensing" within the meaning of the Uruguay Round Agreement on Import Licensing Procedures and, accordingly, that Agreement shall apply in full, subject to the Agreement on Agriculture and to the following more specific and additional obligations.[268]

[263] Ibid. Annex B. [264] Ibid. [265] Ibid. para. 30.
[266] Bali Ministerial Declaration, Adopted 7 December 2013, WT/MIN(13)/DEC.
[267] Ministerial Conference, Ninth Session, Bali, 3–6 December 2013, Understanding on Tariff Rate Quota Administration Provisions of Agricultural Products, as Defined in Article 2 of the Agreement On Agriculture, Ministerial Decision of 7 December 2013, WTO Doc. WT/MIN(13)/39, WT/L/914.
[268] Ibid.

On export competition, Ministers confirmed 'that all forms of export subsidies and all export measures with equivalent effect are highly trade distorting'.[269] Ministers expressed regret that this objective had not been achieved by 2013 as envisaged at the Hong Kong Ministerial meeting in 2005:

> 8. With the objective on export competition set out in the 2005 Hong Kong Ministerial Declaration in mind . . . , we shall exercise utmost restraint with regard to any recourse to all forms of export subsidies and all export measures with equivalent effect. To this end, we undertake to ensure to the maximum extent possible that:
>
> - The progress towards the parallel elimination of all forms of export subsidies and disciplines on all export measures with equivalent effect will be maintained;
> - The level of export subsidies will remain significantly below the Members' export subsidy commitments;
> - A similar level of discipline will be maintained on the use of all export measures with equivalent effect . . .
>
> 10. . . . [W]e commit to enhance transparency and to improve monitoring in relation to all forms of export subsidies . . .

Two of the four agricultural decisions of the Bali package concern food security: In their decision on *General Services*,[270] Ministers expand the green box category to include measures used by developing countries to advance food security:[271]

> [S]ubject to Annex 2 of the Agreement on Agriculture, the types of programmes listed below could be considered as falling within the scope of the non-exhaustive list of general services programmes in Annex 2, paragraph 2 of the AoA . . . :
>
> i. land rehabilitation;
> ii. soil conservation and resource management;
> iii. drought management and flood control;
> iv. rural employment programmes;
> v. issuance of property titles; and
> vi. farmer settlement programmes in order to promote rural development and poverty alleviation.

This is done in recognition that such 'general services' programmes can contribute to rural development, food security, and poverty alleviation, particularly in developing countries. As a consequence, these measures would be exempt from any limitations on domestic support under the current AoA regime.

The Ministerial Decision on *Public Stockholding for Food Security Purposes* tries to accommodate the G-33 and in particular the Indian proposal to exempt food purchases

[269] Ministerial Conference, Ninth Session, Bali, 3–6 December 2013, Export Competition—Ministerial Declaration of 7 December 2013, WTO Doc. WT/MIN(13)/40, WT/L/915.

[270] Ministerial Conference, Ninth Session, Bali, 3–6 December 2013, General Services—Ministerial Decision of 7 December 2013, WTO Doc. WT/MIN(13)/37; WT/L/912 of 11 December 2013.

[271] cf. Christophe Bellmann, Jonathan Hepburn, Ekaterina Krivonios, and Jamie Morrison, 'G-33 Proposal. Early Agreement on Elements of the Draft Doha Accord to Address Food Security, ICTSD Programme on Agricultural Trade and Sustainable Development', Information Note, Geneva, 2013.

at state-determined prices from marginal local producers for food security purposes from developing countries' maximum trade-distorting support. It is noteworthy that the AoA already addresses the issue, in particular in its Annex 2, paragraph 3, footnotes 5, and 5&6:

> Annex 2 Domestic Support: The Basis for Exemption from the Reduction Commitments
>
> 3. Public stockholding for food security purposes[272]
>
> Expenditures (or revenue foregone) in relation to the accumulation and holding of stocks of products which form an integral part of a food security programme identified in national legislation. This may include government aid to private storage of products as part of such a programme.
>
> The volume and accumulation of such stocks shall correspond to predetermined targets related solely to food security. The process of stock accumulation and disposal shall be financially transparent. Food purchases by the government shall be made at current market prices and sales from food security stocks shall be made at no less than the current domestic market price for the product and quality in question.

However, the exemption from AMS only benefits those who have an AMS; most developing countries reported 'zero' base total AMS. Hence, these members are in violation of their AoA commitments, as soon as their food purchase and stockholding programmes exceed the *de minimis* thresholds of AoA Article 6.4.(b). In fairness, these are sufficiently generous for most developing countries, given that they amount to 10 per cent of the value of each product's annual production and 10 per cent of overall agricultural production for non-specific support. But a not insignificant group of developing countries views this as an inherently unfair deal: the big sinners of the past got their status quo (minus the reductions discussed above) protected, whereas those who were not yet in a position to even make the policy choice whether or not to subsidize agriculture remain deprived of any policy space *pro futuro*.

The devil, of course, is in the details and this is not the place to discuss them. Suffice to say, that in response to the very solid argument *pro* more domestic support (in developing countries) two counter arguments come to mind. Those who really push in these discussions are often the countries with very competitive agricultural sectors, which, if well run (examples would be the cases of Brazil, Peru, or South Africa) dominate world markets in certain product categories. Secondly, the acceptance of domestic support in the AoA is a second-best solution: past practices are viewed as being unsustainable and in need of change. The only reason for grandfathering a

[272] [Footnote 5 in the original] For the purposes of paragraph 3 of this Annex, governmental stockholding programmes for food security purposes in developing countries whose operation is transparent and conducted in accordance with officially published objective criteria or guidelines shall be considered to be in conformity with the provisions of this paragraph, including programmes under which stocks of foodstuffs for food security purposes are acquired and released at administered prices, provided that the difference between the acquisition price and the external reference price is accounted for in the AMS.

[Footnotes 5 & 6 in the original] For the purposes of paragraphs 3 and 4 of this Annex, the provision of foodstuffs at subsidized prices with the objective of meeting food requirements of urban and rural poor in developing countries on a regular basis at reasonable prices shall be considered to be in conformity with the provisions of this paragraph.

significantly reduced *status quo ante* is the political impossibility of rapidly changing centuries old practices on which farmers have become reliant. Allowing members to start introducing those practices may very well open a Pandora's box, as the reasons that have brought food security on to the developing world's agenda are truly global in nature: most major agricultural countries seem to be facing much longer periods of drought. This scenario favours political movements in favour of domestic agricultural support worldwide, which does not bode well for successful negotiations.

Discussions in Bali could not be concluded during the scheduled meeting, which ended on 6 December 2013. However, with the unprecedented involvement of Director-General Azevêdo, members agreed the following night to a two-tiered solution:

(1) a temporary Peace Clause (not dissimilar to that which protected Northern agricultural policies during the early years of the AoA; as the Brazilian representative responsible for *Upland Cotton*, Azevêdo was aware of the power of that instrument) 'in relation to support provided for traditional staple food crops in pursuance of public stockholding programmes for food security purposes existing as of the date of this Decision, that are consistent with the criteria of paragraph 3, footnote 5, and footnote 5&6 of Annex 2 to the AoA when the developing Member complies with the terms of this Decision', and
(2) an obligation of conduct, the engagement to find an equitable permanent solution by 2017.

Developing members only benefit from this comprise if they

a. have notified the Committee on Agriculture that it is exceeding or is at risk of exceeding either or both of its Aggregate Measurement of Support (AMS) limits (the Member's Bound Total AMS or the de minimis level) as result of its programmes mentioned above;
b. have fulfilled and continue to fulfil its domestic support notification requirements under the AoA in accordance with document G/AG/2 of 30 June 1995, as specified in the Annex;
c. have provided, and continue to provide on an annual basis, additional information by completing the template contained in the Annex, for each public stockholding programme that it maintains for food security purposes; and
d. provide any additional relevant statistical information described in the Statistical Appendix to the Annex as soon as possible after it becomes available, as well as any information updating or correcting any information earlier submitted.

. . .

4. Any developing Member seeking coverage of programmes under paragraph 2 shall ensure that stocks procured under such programmes do not distort trade or adversely affect the food security of other Members.
5. This Decision shall not be used in a manner that results in an increase of the support subject to the Member's Bound Total AMS or the de minimis limits provided under programmes other than those notified under paragraph 3.a

. . .

7. The Committee on Agriculture shall monitor the information submitted under this Decision.[273]

Footnote 1 of the Decision clarifies that the permanent solution would benefit all developing countries, not just the relatively affluent ones who had already scheduled AMS in 1994.

In the months following the Bali Ministerial Declaration, India increasingly distanced itself from the arrangement it had entered into. As a consequence, it established a rigid nexus between its consent to the conclusion of the new Trade Facilitation Agreement (TFA) and sufficient progress with regard to India's demands for changing the domestic support regime of the AoA. While India was supported, only by a small number of developing countries,[274] it threatened to block the results of the Bali package. On 31 July 2014, Director-General Azevêdo reported to an informal Trade Negotiating Committee (TNC) meeting that 'we have not been able to find a solution that would allow us to bridge the gap' on the adoption of the protocol on the Trade Facilitation Agreement:

> On the one side we have the firm conviction, shared by many, that the decisions that ministers reached in Bali cannot be changed or amended in any way — and that those decisions have to be fully respected.
>
> And on the other side of the debate we have some who believe that those decisions leave unresolved concerns that need to be addressed in ways that, in the view of others, change the balance of what was agreed in Bali. . . .
>
> We have not been able to find a solution that would allow us to bridge that gap.[275]

In November 2014, the WTO General Council accepted an arrangement by the United States and India to extend the Peace Clause indefinitely, and to continue to endeavour to reach a more permanent solution.[276]

[273] Ministerial Conference, Ninth Session, Bali, 3–6 December 2013, Public Stockholding for Food Security Purposes—Ministerial Decision of 7 December 2013, WTO Doc. WT/MIN(13)/38, WT/L/913.

[274] Which included Bolivia, Cuba, South Africa, Venezuela, and Zimbabwe; cf. Bridges, *WTO Trade Facilitation Deal in Limbo as Deadline Passes Without Resolution* 18(28), 31 July 2014, ICTSD (Geneva, 2014).

[275] WTO: 2014 News Items, 31 July 2014, Trade Negotiations Committee—Informal Meeting: Azevêdo: Members unable to bridge the gap on trade facilitation.

[276] cf. General Council, Decisions of 27 November 2014, WTO Doc. WT/L/939, concerning (1) the Decision on Public Stockholding for Food Security Purposes (contained in WT/GC/W688), (2) the Protocol of Amendment to insert the Trade Facilitation Agreement into Annex 1A of the WTO Agreement, and (3) on post-Bali work, <https://www.wto.org/english/thewto_e/minist_e/mc9_e/balipackage_e.htm>.

10

Subsidies and Countervailing Duties

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1. The Power of the Purse

The modern state relies heavily on its spending power: Successful economies, developed or emerging, are characterized by working infrastructures, significant public spending for education, health care, transport, defence. Public servants' salaries should be sufficiently high to make corruption a (criminal) choice and not a necessity for surviving. Beyond that, however, most states, and certainly all developed states,

support, in varying degrees, their domestic industries.[1] Sometimes these policies are called 'industrial policies', declaring openly the strategic reasons for subsidizing *certain* industries and technologies, such as renewable energy. Often, non-economic goals are an alternative reason for supporting domestic industries: maintaining the national capacity to produce modern weapons systems will regularly require the use of subsidies; reducing CO_2 and saving the planet will not happen without subsidies; and developing new drugs that are essential for global and national welfare, but do not cater to many wealthy customers (for instance, an anti-Ebola drug or a super-antibiotic which would have to be used as restrictively as possible in order to avoid the developments of resistances that have diminished the effect of standard antibiotics) is all but impossible without subsidies.

As we will discuss later, these forms of public spending are the concern of WTO law—in particular GATT Article XVI and the Agreement on Subsidies and Countervailing Measures (SCM)—only, if they target specific firms (which may be difficult to avoid, due to the structure of the industry, for example, in the pharmaceutical and other high-tech industries). Even then, however, WTO law does not prohibit them, but rather limits itself to the legal obligation to do no harm, or, in other words, not to use subsidies that have 'adverse effects' on fellow WTO members. Such an adverse effect occurs in three prototypical scenarios: (1) WTO member IM imports subsidized products from fellow member EX that harm the domestic industry of 'like products' due to the price competition rendered possible by the subsidization; (2) IM does not import the products mentioned in scenario (1); however, the consumers in an important third country TRE do, and the exports from IM to TRE shrink significantly, due to the effect of surging subsidized imports from EX; (3) lastly, IM subsidizes its inefficient domestic industry to withstand the import competition from products originating and efficiently produced in EX.

Whereas the legitimacy of both subsidies and the defence against harmful effects of these subsidizations, are rather straightforward from the mercantilist world-view that is at the basis of WTO regime, the economic rationale for and against both subsidies and countervailing measures are much disputed. The main arguments against subsidies are as follows.[2]

- They may lead to inefficient allocation of resources and thus diminish welfare. The obvious counterargument (remember the anti-Ebola drug) is the ubiquity of market failure, and, in addition, the view that the market is an instrument for implementing political choices, not for creating them: for instance, as many newly independent states will confirm, liberty may be more important than economic well-being. The North American settlers certainly thought so, and so did many peoples who acquired independence regardless of 'market sentiments'. Whether the world is coming to an end in a hundred years due to environmental pollution, or not, may not be considered by markets today, but is of the greatest concern

[1] It is reported that the CEO of one of the 'Big Three' US car manufacturers complained about their overseas competitors receiving subsidies, whereas American companies just received some tax breaks.

[2] cf. in detail Dominic Coppens, *WTO Disciplines on Subsidies and Countervailing Measures: Balancing Policy Space and Legal Constraints* (Cambridge: Cambridge University Press, 2014) 5 *et seq*.

for humankind, who tends to delegate the task of planning for the future to governments.

- They are inherently unfair. This argument comes in several forms. The straightforward one is that only those countries that can afford it subsidize. Therefore, subsidies are a 'rich man's instrument', and should—at the very least—not be used in a way that would negatively affect those countries that do not belong to that club. A variation of this argument is the one saying that it is unfair to externalize one's own real problems on a neighbour ('beggar thy neighbour'): Do not address your socio-economic problems by harming your fellow WTO partner. Then there is the unfairness which lies in the exposure of a lean and efficient operator—who might have taken, possibly with the help of its home state, all the difficult steps to reach its current competitive position—to an inefficient, but heavily subsidized competitor, who, due to the power of the purse of a mid-size state can offer prices that make consumers forget their loyalties. The worst-case scenario in that line of thought would be that the inefficient operator, once it becomes the sole survivor of the price wars starts reaping in its monopoly rent while 'serving' its customers with junk products. While the latter scenario is as old as 'unfair trade' arguments, it seems less relevant in practical terms. However, the former scenario may very well be real, and is—in the eyes of the WTO members—unacceptable. It goes without saying that the two lines of reasoning are not mutually exclusive but overlap.
- Even those, who accept that subsidies are, for either some or all of the above reasons, suboptimal and undesirable, may not always agree on the wisdom of unilaterally counteracting.[3] There is a track record of inefficient and politically well-connected domestic industries trying to restrict market access for excellent imports through 'red tape' and 'kitchen sink' legal attacks ('throw everything at them, something will stick'). Countervailing duty investigations are an integral and cherished part of those tactics, and have, in their own right, become a successful export item for specialized law firms in Washington, Brussels, and Toronto, and increasingly their counterparts in Delhi, Johannesburg, São Paolo, Seoul, and Shanghai. They also happen to be trade impediments that nullify the negotiated conditions on market access.[4]

Whereas the original GATT followed a much more lenient approach,[5] the current status quo—presented in this chapter—is rather protective of the interests of the domestic industries and rather restrictive with regards to subsidization. The interests of consumers, in contrast, receive no or little attention. Some features have remained the same over time: subsidies paid to domestic producers were (and continue to be) exempted from the national treatment obligation (GATT Article III:8(b)). GATT

[3] cf. Alan Sykes, 'Countervailing Duty Law: An Economic Perspective' (1989) *Columbia Law Review*, Vol. 89, 199, 203.

[4] cf. Petros C. Mavroidis, Patrick A. Messerlin, and Jasper M. Wouters, *The Law and Economics of Contingent Protection in the WTO* (Edward Elgar, 2008) 293 *et seq.*; Luca Rubini, *The Definition of State Aid—WTO and EC Law in Comparative Perspective* (Oxford: Oxford University Press, 2010) 25 *et seq.*

[5] cf. Andrew Stoler, 'The Evolution of Subsidies Disciplines in GATT and the WTO' (2010) *Journal of World Trade* 44, 797–808.

Articles XVI and VI—still the foundation of today's complex subsidies and countervailing duties law and the basis for the parallelism of antidumping and 'anti-adverse-effects-having-subsidies' law[6]—recognize subsidies as a legitimate instrument of public policy, obliging members only to forsake export subsidies for non-agricultural products and to avoid affecting their partners' interest in an unfavourable way. They also allow unilateral remedies (countervailing duties) against subsidized imports that harm the domestic industry in a significant fashion, by levying additional duties in excess of tariffs bound in accordance with GATT Article II.

The relative leniency with which the GATT drafters dealt with subsidies, reflected an understanding that they are an instrument of government policy for almost all, if not all, member countries. Nevertheless, subsidies may undermine the market access expectations that result from bargained tariffs and other trade concessions: bargaining down to a low tariff rate will be a bad deal, if the importing country grants subsidies that prevent any realistic possibility of import competition.[7] Whereas the GATT aimed to ensure that subsidies do not remove the incentive to make tariff concessions, today's SCM goes somewhat further than that.[8] It is an integral part of the WTO Agreement (Article II:1), binding upon all WTO members, and a covered agreement for the purposes of the Dispute Settlement Understanding (DSU) (cf. DSU Article 1.1). It embodies a not always easy compromise between different perspectives on subsidies, utilizing categories and concepts that (as will be seen) may not have any obvious economic or policy rationale, but instead reflect a difficult and, in some respects, incoherent political bargain:

> [T]he object and purpose of the *SCM Agreement*... reflects a delicate balance between the Members that sought to impose more disciplines on the use of subsidies and those that sought to impose more disciplines on the application of countervailing measures. Indeed, the Appellate Body has said that the object and purpose of the *SCM Agreement* is "to strengthen and improve GATT disciplines relating to the use of both subsidies and countervailing measures, while, recognizing at the same time, the right of Members to impose such measures under certain conditions".[9]

It should be noted that the the Appellate Body has rightly recognized that the SCM and GATT Article XVI are not to be construed in isolation from each other.[10] Whether that leaves room for a direct application of GATT Article XX or rather an interpretation of the SCM that emphasizes the fundamental parallelism between the GATT and the SCM with regard to rule and exception, and in particular with regard to the relationship between legitimate state action and SCM disciplines, has yet to be authoritatively

[6] See, for instance, *China—GOES* (Appellate Body), paras.133 *et seq.*, 233, 253 *et seq.*

[7] Note that fundamentally all concessions 'have been paid for' through corresponding concessions, negotiated in the multilateral trade rounds.

[8] According to Gary Horlick and Peggy Clark, 'The 1994 WTO Subsidies Agreement' (1994) *World Competition* 17, 41–54 the SCM was possible thanks to a last-minute compromise between the US and the EC, who, following years of diametrically opposed opinions on this issue, reached a certain *rapprochement* during the presidency of Bill Clinton.

[9] *US—Countervailing Duty Investigation on DRAMs* (Appellate Body), para. 115, citing *US—Softwood Lumber IV* (Appellate Body), para. 64.

[10] *US—FSC* (Panel), para. 7.82 relying on *Brazil—Desiccated Coconut* (Appellate Body), 16.

determined. In the *Canada—Renewable Energy* case, the Appellate Body interpreted a package of state measures through which state aid was granted to facilitate the development of alternative energies as the least trade-restrictive measure to pursue a legitimate state interest and insulated it from the application of the case law discussed in the following sections by treating the state action in question as the establishment of a separate market.

Whereas one may read this as an implied refusal to read GATT Article XX into the SCM, it is certainly an effort to find a balance between the protection from subsidized goods, on one hand, and of the pursuit of legitimate state interests, on the other hand.[11]

As one of its major achievements, the SCM for the first time provides a legal definition of what constitutes a subsidy for the purposes of the multilateral trading system; in the preceding forty years, the then contracting parties to the GATT 1947 had not been able to resolve that matter. Three categories of subsidies are being created, with the third one having ceased to exist but still worth mentioning for illustrative (and educational) purposes:

(a) Prohibited subsidies (red light subsidies): The only instance where state aid is explicitly prohibited are export subsidies and subsidies tied to the use of local content;

(b) Allowed subsidies (green light subsidies): Pursuant to SCM Article 8, three types of subsidies (regional aid, environmental, and research and development) were protected from any countermeasure ('non actionable'). While SCM Article 8 was only in force in the first five years of the WTO, the underlying effort to reconcile subsidy discipline and financial state support for legitimate state interests remains as relevant as ever.

(c) All other subsidies (unless *specifically* regulated by the Agreement on Agriculture (AoA) or other agreements): Pursuant to the SCM, any subsidy may trigger countermeasures, by one means or another, provided it has a negative impact on another member.

The following chapter is structured as follows: First, we discuss the definition of subsidies[12] (section 2) and the classification of subsidies (sections 3 and 4). Then, we examine the institutional mechanisms aimed at counteracting subsidies (sections 5 and 6). In this regard, the SCM offers two possibilities, which were for the first time elaborated in the Tokyo Round Subsidies Code:

(a) WTO members can challenge the legality of the subsidization as such; this is *ab initio* a multilateral avenue (sometimes also referred to as 'multilateral track'), whereby a negatively affected WTO member will request the establishment of a Panel to adjudicate on whether a particular subsidy or programme is WTO-consistent or not;

[11] cf. the criticism of Luca Rubini, 'The Good, the Bad, and the Ugly. Lessons on Methodology in Legal Analysis from the Recent WTO Litigation on Renewable Energy Subsidies' (2014) *Journal of World Trade* 5, 895–936.

[12] cf. *US—FSC* (Panel), para. 7.80.

(b) WTO members can also, provided that the necessary conditions are met, impose countervailing duties (CVDs) against subsidized imports which harm, their domestic producers of like products. This clearly starts as a unilateral action (sometimes also referred to as 'unilateral track'), whereby a WTO member determines an additional charge, the 'countervailing' duty. Of course, this unilateral measure will routinely be challenged by the targeted state, thus bringing the matter eventually within the realm of the DSU and its adjudicative bodies. While CVDs have been the traditional approach to undoing the negative effect of subsidies, they have become market access impediments in their own right. As a consequence, the SCM establishes disciplines for their lawful imposition. At the time of writing, all major trading partners had provisional or definitive countervailing duty measures in place.[13]

Note that CVDs can only neutralize competitive effects of subsidies in the domestic market of the CVD-imposing member (scenario (1) above). Competitive disadvantages for a country's exports to third countries can only be addressed by challenging the WTO-compatibility of the subsidy in question pursuant to the multilateral avenue mentioned at (a) above and explored in section 5 of this chapter. SCM Article 10, footnote 35 clarifies that these two forms of relief can be used simultaneously.[14] However (and in line with general rules of state responsibility), the member affected may only seek 'relief' once: either it imposes a CVD on the subsidized product upon importation, with the effect of undoing the unfair price advantage through an additional duty. Or, alternatively, the successful complaining state may, pursuant to the DSU, suspend trade benefits commensurate with the harm done. 'Double-dipping' is prohibited, and footnote 35 makes that unequivocally clear. However, WTO members may legitimately counter a subsidy by another WTO member by imposing CVDs to address injury in their domestic market, while pursuing the multilateral avenue (including eventually countermeasures pursuant to DSU Article 22) to address injury suffered in their export markets, as that wrong cannot be addressed by CVDs. In this regard neither the letter nor the spirit of footnote 35 exclude the simultaneous but not overlapping use of both CVDs and of the multilateral track.

2. The Scope of the SCM Agreement: Specific Subsidies

Pursuant to SCM Article 1 a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as 'government'), i.e. where:

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

[13] Report (2014) of the Committee on Subsidies and Countervailing Measures, G/L/1077.

[14] 'The provisions of Part II or III may be invoked in parallel with the provisions of Part V; however, with regard to the effects of a particular subsidy in the domestic market of the importing Member, only one form of relief (either a countervailing duty, if the requirements of Part V are met, or a countermeasure under Articles 4 or 7) shall be available.'

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);

(iii) a government provides goods or services other than general infrastructure, or purchases goods;

(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;

or (a)(2) there is any form of income or price support in the sense of [Art. XVI GATT];

and

(b) a benefit is thereby conferred.

However, only targeted ('specific') subsidies are covered by the SCM, pursuant to SCM Article 2: the SCM does not want to undo the competitive advantages that follow from being located in a state where the infrastructure is working well (usually at the price of significant tax burdens), but rather wants to discipline targeted support for economic operators who are in competition with other WTO members' producers of like products.

Therefore, a state aid is covered by the disciplines of the SCM only if it fulfils cumulatively the following three elements: (1) the subsidy must represent a financial contribution[15] by a government or any public body of a member; (2) it must confer[16] a benefit;[17] and (3) it must target a specific recipient. We shall address these criteria in turn.

2.1 Financial contribution

SCM Article 1 distinguishes between a financial contribution being made,[18] and some form of income or price support taking place.[19] As to the former, SCM Article 1.1 distinguishes between two situations:

[15] cf. *US—Softwood Lumber IV* (Appellate Body), paras. 142, 143; *US—Upland Cotton* (Appellate Body), para. 471. One might still find in the literature the term *cost to government* used as a synonym for financial contribution. In its report on *Canada—Aircraft* (Appellate Body), the Appellate Body confirmed the Panel's understanding regarding the irrelevance, for the purposes of interpreting the SCM, of the term *cost to government*. In its view, this term can be misleading since *financial contributions* are not necessary a *cost to government*; cf. paras. 149–61, in particular 155.

[16] cf. *Canada—Aircraft* (Appellate Body), paras. 154 and 157; *US—Lead and Bismuth II* (Appellate Body), paras. 58 and 68; *US—Countervailing Measures on Certain EC Products* (Appellate Body), paras. 102, 108, 110, 112 and 113, 115–16, 118, 126, and 127; cf. *US—Countervailing Duty Investigation on DRAMs* (Appellate Body), para. 205 and fn. 377 of the report; *Japan—DRAMs (Korea)* (Appellate Body), para. 172.

[17] cf. *US—Large Civil Aircraft* (2nd complaint) (Panel), paras. 7.168–7.178, 7.332, 7.475–7.480, 7.588, 7.834, 7.903–7.908, 7.1037–7.1041, 7.1182–7.1185, 7.1229, 7.1362, and 7.1400—7.1404; *EC and certain member States—Large Civil Aircraft* (Appellate Body), paras. 702–10, 923–9, 969–93, 995–1012, and 1013–27.

[18] SCM Art. 1.1(a)(1).

[19] SCM Art. 1.1(a)(2).

(a) a government (or a public body) provides directly either funds, goods, services, or foregoes income due; or

(b) a government participates indirectly by channelling payments through a private body. Payments genuinely attributable to private entities only, meaning that they are not in some way attributable to a government or public body—cannot constitute a "financial contribution" for purposes of determining the existence of a subsidy under the SCM Agreement.[20]

The term 'financial contribution' has been authoritatively determined by the Appellate Body in *Softwood Lumber IV*:[21]

> An evaluation of the existence of a financial contribution involves consideration of the nature of the transaction through which something of economic value is transferred by a government. A wide range of transactions falls within the meaning of "financial contribution" in Article 1.1(a)(1). According to paragraphs (i) and (ii) of Article 1.1(a)(1), a financial contribution may be made through a direct transfer of funds by a government, or the forgoing of government revenue that is otherwise due. Paragraph (iii) of Article 1.1(a)(1) recognizes that, in addition to such monetary contributions, a contribution having financial value can also be made *in kind* through governments providing goods or services, or through government purchases. Paragraph (iv) of Article 1.1(a)(1) recognizes that paragraphs (i)–(iii) could be circumvented by a government making payments to a funding mechanism or through entrusting or directing a private body to make a financial contribution. It accordingly specifies that these kinds of actions are financial contributions as well.[22]

In *Canada—Renewable* and *US—Large Civil Aircraft* (2nd complaint) the Appellate Body emphasized that its approach does not expressly preclude that a transaction could be covered by more than one subparagraph.[23]

> When determining the proper legal characterization of a measure under Article 1.1(a)(1) of the SCM Agreement, . . . a panel should scrutinize the measure both as to its design and operation and identify its principal characteristics. Having done so, the transaction may naturally fit into one of the types of financial contributions listed in Article 1.1(a)(1). However, transactions may be complex and multifaceted. This may mean that different aspects of the same transaction may fall under

[20] *US—Countervailing Duty Investigation on DRAMs* (Appellate Body), para. 107.

[21] *US—Softwood Lumber IV* (Appellate Body), para. 52.

[22] '[Footnote in the original] We note, however, that not all government measures capable of conferring benefits would necessarily fall within Article 1.1(a). If that were the case, there would be no need for Article 1.1(a), because all government measures conferring benefits, per se, would be subsidies. In this regard, we find informative the discussion of the negotiating history of the *SCM Agreement* contained in the panel report in *US—Export Restraints*, which was not appealed. That panel, at paragraph 8.65 of the panel report, said that the ". . . negotiating history demonstrates . . . that the requirement of a financial contribution from the outset was intended by its proponents precisely to ensure that not all government measures that conferred benefits could be deemed to be subsidies." This point was extensively discussed during the negotiations, with many participants consistently maintaining that only government actions constituting financial contributions should be subject to the multilateral rules on subsidies and countervailing measures. [footnote omitted]'.

[23] *Canada—Renewable Energy* (Appellate Body), para. 5.119; *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 613.

different types of financial contribution. It may also be the case that the characterization exercise does not permit the identification of a single category of financial contribution and, in that situation, as described in the *US—Large Civil Aircraft (2nd complaint)* Appellate Body report, a transaction may fall under more than one type of financial contribution.... [T]he fact that a transaction may fall under more than one type of financial contribution does not mean that the types of financial contributions set out in Article 1.1(a)(1) are the same or that the distinct legal concepts set out in this provision would become redundant, as the Panel suggests. We further observe that, in *US—Large Civil Aircraft (2nd complaint)*, the Appellate Body did not address the question of whether, in the situation described above, a panel is under an obligation to make findings that a transaction falls under more than one subparagraph of Article 1.1(a)(1).[24]

2.1.1 Direct transfer of funds

The first type of financial contribution listed in SCM Article 1.1(a)1(i) is a 'government practice [that] involves a direct transfer of funds'. The Agreement goes on to give three examples for such direct transfers: grants, loans, and equity infusion.[25] By explicitly using the Latin acronym for 'for example' ('e.g.', '*exemplum gratum*'), the drafters of the SCM made exceedingly clear that these examples 'do not exhaust the class of conduct captured by subparagraph (i)'.[26] Rather, SCM Article 1.1(a)1(i) covers any form of state support that increases the financial breathing space of the beneficiary b*y means equivalent to the ones listed* in an exemplary fashion.

> [T]ransactions that are similar to those expressly listed are also covered by the provision [and include:] Debt forgiveness, which extinguishes the claims of a creditor, is a form of performance by which the borrower is taken to have repaid the loan to the lender. The extension of a loan maturity enables the borrower to enjoy the benefit of the loan for an extended period of time. An interest rate reduction lowers the debt servicing burden of the borrower. In all of these cases, the financial position of the borrower is improved and therefore there is a direct transfer of funds within the meaning of Article 1.1(a)(1)(i).[27]

Note that the SCM also includes explicitly the 'potential direct transfers of funds or liabilities (e.g. loan guarantees)'.[28] This confirms the broad scope of the concept of 'direct transfer of funds': it suffices that the financial possibilities of an operator is enhanced. The last example also shows that there need not be a cost to government:[29] Imagine the following scenario: a state borrows money at a premium rate of 2 per cent p.a. The (hypothetical) agency in charge of subsidizing promising start-up companies

[24] *Canada—Renewable Energy* (Appellate Body), para. 5.120; quoting *China—Auto Parts* (Appellate Body), para. 171 and *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 586.
[25] All three authoritatively interpreted in *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 616.
[26] Ibid. para. 615. [27] *Japan—DRAMs (Korea)* (Appellate Body), para. 251.
[28] SCM Art. 1.1(a)1(i) *in fine*.
[29] cf. *US—Countervailing Measures on Certain EC Products* (Appellate Body), para. 108: '[T]he "cost to government" [is] not to be the relevant benchmark for identifying the "benefit"'.

lends the money, increasing the annual rate by 50 per cent to 3 per cent p.a. in order to cover all administrative costs and the insurance premiums for defaults. As a consequence, a start-up company may get a loan at a rate of 3 per cent, whereas it would struggle to get financing at market conditions. If it could find a commercial lender with a sufficiently healthy appetite for risk, it would have to pay a significantly higher rate than a standard commercial debtor (who would pay, hypothetically, 5 per cent). We are therefore looking at a subsidy with no cost for the government. If one were to modify this hypothetical example and let the government charge 3.5 per cent as its 'start-up-special rate', the state could even achieve a profit, without thereby changing the character of that measure as a financial contribution, and ultimately as a subsidy for the purposes of the SCM.

In contrast, state measures leading to an undervalued currency (rendering exports cheaper for foreign consumers) are of a different nature. Whereas such measures may pose significant problems for trade, they would seem to be very dissimilar from the support measures listed in SCM Article 1.[30]

2.1.2 Forgoing or not collecting government revenue that is otherwise due

Pursuant to SCM Article 1.1(a)1(ii), a financial contribution may also be deemed to exist where 'government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)'. The footnote to this provision reinforces the impression that the coverage is broad indeed, as it excludes specifically 'the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued'. That the negotiators viewed it necessary to exclude reimbursement of VAT upon exportation—a standard practice in many countries—shows that they drafted the text on the hypothesis that without such limitation obtaining a VAT refund upon exportation of goods could be considered a financial contribution for the purposes of the SCM.

Standard examples of 'foregoing or not collecting' are the partial non-enforcement of tax laws in order to assist struggling enterprises. So far, complaints which eventually reached the Appellate Body did not have to deal with that sort of 'positive discrimination' through administrative action, but rather with preferential legislation for certain industries or corporate structures. *US—FSC* is an example of that line of cases:

> [T]he "*foregoing*" of revenue "*otherwise due*" implies that less revenue has been raised by the government than would have been raised in a different situation, or, that is, "otherwise". Moreover, the word "foregone" suggests that the government has given up an entitlement to raise revenue that it could "otherwise" have raised. This cannot, however, be an entitlement in the abstract, because governments, in theory, could tax *all* revenues. There must, therefore, be some defined, normative benchmark against which a comparison can be made between the revenue actually raised and the revenue

[30] cf. Robert W. Staiger and Alan O. Sykes, 'Currency Manipulation and World Trade', Stanford Law and Economics Olin Working Paper No. 363, available at <http://www.nber.org/papers/w14600.pdf>.

that would have been raised "otherwise". . . . A Member, in principle, has the sovereign authority to tax any particular categories of revenue it wishes. It is also free *not* to tax any particular categories of revenues. But, in both instances, the Member must respect its WTO obligations. What is "otherwise due", therefore, depends on the rules of taxation that each Member, by its own choice, establishes for itself.[31]

US—FSC concerned a legal challenge by the EC of a US measure which exempted income of certain US economic operators (Foreign Sales Corporations, FSC) generated outside of the United States from taxation. According to US law, *all* income of US economic operators is—in principle—taxable in the United States, regardless of where it is generated. Without the special FSC legislation, US FSCs would have had to pay taxes to the United States. Therefore, the EC was of the opinion that the United States were forgoing income otherwise due.

Given that the EC did not complain about the non-execution of a law by an executive organ, but rather an Act of the US legislator, this is, at first sight, not an easy argument, as members 'have the sovereign authority to determine their own rules of taxation'.[32] The conclusion that the legislator 'foregoes income otherwise due' is only tenable if the legislator has established a normative benchmark that permits the conclusion that specific beneficiaries benefit from a deviation from the 'standard operating procedure'. In other words, a comparison of the fiscal treatment of legitimately comparable income is needed to determine whether the contested measure involves the forgoing of revenue:

[U]nder Article 1.1(a)(1)(ii), a "financial contribution" does not arise simply because a government does not raise revenue which it could have raised. It is true that, from a *fiscal* perspective, where a government chooses not to tax certain income, no revenue is "due" on that income. However, although a government might, in a sense, be said to "forego" revenue in this situation, this alone gives no indication as to whether the revenue foregone was "otherwise due". . . .

[T]he treaty phrase "otherwise due" implies a comparison with a "defined, normative benchmark". . . . [T]he comparison . . . [which] must necessarily be between the rules of taxation contained in the contested measure and other rules of taxation of the Member in question. Such a comparison enables panels and the Appellate Body to reach an objective conclusion. . . .

In identifying the normative benchmark, there may be situations where the measure at issue might be described as an "exception" to a "general" rule of taxation. In such situations, it may be possible to apply a "but for" test to examine the fiscal treatment of income absent the contested measure. We do not, however, consider that Article 1.1(a)(1)(ii) always *requires* panels to identify, with respect to any particular income, the "general" rule of taxation prevailing in a Member. . . . Instead, we believe that panels should seek to compare the fiscal treatment of legitimately comparable income to determine whether the contested measure involves the forgoing of revenue which is "otherwise due", in relation to the income in question.

[31] *US—FSC* (Appellate Body), para. 90 referring, inter alia, to *Japan—Alcoholic Beverages II* (Appellate Body), 16 and *Chile—Alcoholic Beverages* (Appellate Body), paras. 59–60.

[32] *US—FSC (Article 21.5—EC)* (Appellate Body), paras. 89 and 139.

> In addition, it is important to ensure that the examination under Article 1.1(a)(1)(ii) involves a comparison of the fiscal treatment of the relevant income for taxpayers in comparable situations. For instance, if the measure at issue is concerned with the taxation of foreign-source income in the hands of a domestic corporation, it might not be appropriate to compare the measure with the fiscal treatment of such income in the hands of a foreign corporation. [Italics in the original.][33]

In *US—Large Civil Aircraft* (2nd complaint), the Appellate Body warned of 'the limitations inherent in identifying and comparing a general rule of taxation':

> For instance . . . it could be misleading to identify a benchmark within a domestic tax regime solely by reference to historical tax rates. By that measure, the fact that commercial aircraft and component manufacturers were *previously* subject to higher tax rates would not in itself be determinative of what the benchmark is at the time of the challenge. . . .
>
> We have also noted that it could be misleading to compare rates applicable to a general category of income with rates applicable to a subcategory of that income, without considering whether the scope of the "exceptions" undermines the existence of a "general rule".[34]

The WTO does not impose uniform tax policies. As a result, regulatory asymmetry in tax policies is common. In the same vein, the same transaction may get taxed twice: one country might impose taxes by virtue of the nationality of the economic operator; another may choose to do so by virtue of the place where the transaction takes place. If enough countries are involved—which is a realistic possibility in the age of global value chains[35]—an operator may be taxed at 100 per cent or potentially even more. This would obviously stifle economic activity and would kill the goose that lays the golden (tax) eggs. Most developed and many developing countries address this issue through double taxation agreements, which prevent burdening the same taxable activity twice. Could such rules be viewed as financial contribution pursuant to SCM Article 1.1(a)(1)(ii)? Given the prior discussion regarding the 'taxes otherwise due', the answer would have to be affirmative. However, that is only the beginning, not the end of the legal analysis. First, with regard to export subsidies, footnote 59 to the Annex I of the SCM states that '[p]aragraph (e) [of the Annex I] is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member'.[36] Thus, even *unilateral* measures intended to avoid double taxation, such as remission of taxes, should not be understood

[33] *US—FSC (Article 21.5—EC)* (Appellate Body), paras. 88–92.

[34] *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), paras. 823–4.

[35] World Investment Report 2013—Global Value Chains: Investment and Trade for Development, UNCTAD: Geneva, 2013.

[36] SCM fn. 59; para. (e), to which the footnote refers is included in the Illustrative List of Export Subsidies and reads as follows: 'The full or partial exemption remission or deferral specifically related to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises.' For a thorough study on export subsidies see Andrew Green and Michael Trebilcock, 'Enforcing WTO Obligations: What Can We Learn from Export Subsidies?' (2007) *Journal of International Economic Law* 10, 653–83; Dominic Coppens, 'How Much Credit for Export Credit Support under the SCM Agreement?' (2009) *Journal of International Economic Law* 12, 63–113.

to be an export subsidy for the purposes of the SCM. With regard to double taxation agreements, one should note that they reflect the joint understanding of the state parties concerned. As international agreements in their own right, they represent context that would have to be taken into account when interpreting SCM Articles 1 to 3.[37] *US—FSC (Article 21.5—EC)* dealt with this issue and provides the legal test for distinguishing between what is acceptable and what is not in this context. In its view, a measure falls within footnote 59, if it exempts from taxation only foreign-source income.[38] Note that if a measure has been found not to be an export subsidy pursuant to footnote 59, this does not prejudice other provisions of the SCM from applying, provided the measure constitutes a subsidy as defined in SCM Articles 1 and 2.[39]

2.1.3 Providing goods or services other than general infrastructure, or purchasing goods

In *US—Softwood Lumber IV*, the Appellate Body undertook to interpret the third specifically defined form of financial contribution ('a government provides goods or services other than general infrastructure, or purchases goods'):

> [T]he Article contemplates two distinct types of transaction. The first is where a government provides goods or services other than general infrastructure. Such transactions have the potential to lower artificially the cost of producing a product by providing, to an enterprise, inputs having a financial value. The second type of transaction falling within Article 1.1(a)(1)(iii) is where a government purchases goods from an enterprise. This type of transaction has the potential to increase artificially the revenues gained from selling the product.[40]

It seems that by using the term 'artificial' above, the Appellate Body reveals its real concerns here: what is at stake is the WTO-incompatible manipulation of the competitive relationships between subsidized operators (that enjoy the market access benefits of the GATT) and those producers of like products that do not benefit from access to state aid. To illustrate the Appellate Body's point, one may turn to prior examples provided by the *Softwood Lumber* saga: In *Softwood Lumber III*, the Panel had to deal with the often factually complex and legally complicated constructions that governments use to support their big exporters.

> [W]e understand that most forest land in the covered provinces of Canada is Crown land and that interested persons who want to harvest on such Crown land have to enter into tenure or licensing agreements. . . . In general, such tenure and licensing agreements . . . allow . . . the "tenure holder" . . . to harvest the standing timber on a particular parcel of Crown land. In return, the tenure holders commit themselves to a number of obligations, including at a minimum (i) service and maintenance

[37] cf. Arts. 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT).

[38] *US—FSC (Article 21.5—EC)* (Appellate Body), paras. 184–6.

[39] *US—FSC* (Appellate Body), para. 93: 'footnote 59 does not purport to establish an exception to the general definition of a "*subsidy*" otherwise applicable throughout the entire *SCM Agreement*'.

[40] *US—Softwood Lumber IV* (Appellate Body), para. 53.

> obligations, such as road-building and maintenance, and protection against fire, disease, and insects; (ii) implementation of forestry management and conservation measures, including silviculture and reforestation; and (iii) payment of a volumetric "stumpage charge" that is levied upon the exercise of the harvesting right.[41]

The Panel then went on to explain why in its view the Canadian stumpage programme constitutes a financial contribution in the sense of SCM Article 1:

> In Article 1.1(a)(1)(iii) SCM Agreement, "goods" is used in the context of "goods or services other than general infrastructure". . . . In our view, the sentence "goods or services other than general infrastructure" refers to a very broad spectrum of things a government may provide. The fact that the only exception provided for in subparagraph (iii) is general infrastructure reinforces our view concerning the unqualified meaning of the term goods as used in this provision. . . .
>
> . . . . Canada refers to certain provisions which contain the term "imported goods", and concludes on that basis that wherever the term "goods" is used in the Agreement, it refers to products which are capable of being imported and traded across borders. We find no basis for such a conclusion in the text of the SCM Agreement. Although "goods" in Article 1.1(a)(1)(iii) SCM Agreement certainly includes tradable products, there is no reason to limit its meaning to only such products, particularly where the immediate context in which the term is used does not suggest such a limitation. In particular, this provision states that when the government provides "goods or services", this constitutes a financial contribution. The "goods" in question are not imported or exported, simply provided by the government, and nothing suggests therefore that the goods in question need to be tradeable products with a potential or actual tariff line. Goods in this context are distinguished from services, and in our view the two cover the full spectrum of in-kind transfers the government may undertake by providing resources to an enterprise. Our view is reinforced by the fact that there is only one exception among all possible goods and services that could be provided by the government—general infrastructure—which is explicitly defined as not constituting a financial contribution. We thus find that there is no basis in the text of the SCM Agreement to conclude that "goods" in Article 1.1 is limited to products with an actual or potential tariff line.[42]

In *Canada—Renewable Energy*, the Appellate Body confirmed the broad reading of 'goods' in the context of the second type of transaction falling within SCM Article 1.1(a)(1)(iii) and held that good for the purposes of that provision encompasses electricity.[43]

Of course, an apex of fact-intensive analysis of highly complex state support structures has been reached in the *Airbus–Boeing* dispute. The Appellate Body reports on that matter will fill thousands of pages.[44] With regard to SCM Article 1.1(a)(1)(iii) the Appellate Body stated there:

[41] *US—Softwood Lumber III* (Panel), para. 7.14.

[42] Ibid. paras. 7.23 and 7.28. The Appellate Body, in *US—Softwood Lumber IV* (Appellate Body), confirmed this view in para. 53 *et seq.*

[43] *Canada—Renewable Energy* (Appellate Body), para. 5.124, confirming the Panel.

[44] So far, only *US—Large Civil Aircraft* (2nd complaint) (Appellate Body); *EC and certain member States—Large Civil Aircraft* (Appellate Body) have been published, but with no end of the dispute in sight.

> In the case of the provision of goods or services, subparagraph (iii) does not specify whether the goods or services are provided gratuitously or in exchange for money or other goods or services. Thus, the provision of goods or services may include transactions in which the recipient is not required to make any form of payment, as well as transactions in which the recipient pays for the goods or services. Therefore, what is captured in the first sub-clause of subparagraph (iii), as well as in subparagraph (i), is a government's provision or goods or services, or of funds, irrespective of whether this is done gratuitously or in exchange for consideration. The difference between the two types of government conduct, however, lies in what is being transferred by the government. Under subparagraph (i), the government transfers financial resources, while under subparagraph (iii) (first sub-clause), the government provides a good or service.
>
> With respect to the second sub-clause of subparagraph (iii)—where a government "purchases goods"—we note that the goods are provided *to* the government by the recipient, in contrast to the first sub-clause of that paragraph, where the goods are provided *by* the government. There are two additional differences between the first and second sub-clauses of subparagraph (iii). The second sub-clause uses the term "purchase", which is usually understood to mean that the person or entity providing the goods will receive some consideration in return. The other difference is that, in contrast to the first sub-clause that addresses the provision of goods *and services*, the second sub-clause refers only to purchases of "goods", and not of "services".[45]

Clearly, any provision of goods or service that is covered by the term 'general infrastructure' would not be covered by SCM Article 1.1(a)(1)(iii).[46]

2.1.4 *Use of a private entity as intermediary*

It is well established in international law that regardless of whether state officials or private entities are taking actions, the state (a legal person) is liable for these actions, provided these are attributable to the state. In the case of state organs that attribution will, in most cases, be rather straightforward, whereas acts of private entities—be they mercenaries, banks, or airlines—are typically exactly that: acts of private entities, entailing no state responsibility. But private conduct may be attributed to the state, if 'the person or group of persons is in fact acting on the instructions of, or under the direction or control of, that State in carrying out the conduct.'[47]

The drafters of the SCM did not want to draw on that insight and the well-established pertinent jurisprudence; rather, they included their own *lex specialis* in order to ensure that any use of seemingly private funding would be a subsidy for the purposes of the SCM, provided that the state was the ultimate donor. Thus, pursuant to

[45] *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), paras. 618, 619; importantly, the Appellate Body did not rule on whether the Panel's view that the omission of 'services' in the second sub-clause of SCM Art. 1.1(a)(1)(iii) was meant to exclude services from the coverage of that second sub-clause; ibid. para. 620.

[46] cf. *EC and certain member States—Large Civil Aircraft* (Panel), para. 7.1036: 'Infrastructure that is not provided to or for the advantage of only a single entity or limited group of entities, but rather is available to all or nearly all entities.'

[47] cf. Art. 8 ILC Draft Articles on State Responsibility, which enshrine well-established principles of general public international law.

SCM Article 1.1(a)(1)(iv) a financial contribution (and ultimately a subsidy) is deemed to exist, when

> a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments.

Clearly, not all governmental measures vis-à-vis a private intermediary would necessarily amount to entrustment or direction. The terms 'entrustment and direction' demand a significant degree of command and control authority on the side of the government:

> "[E]ntrustment" occurs where a government gives responsibility to a private body, and "direction" refers to situations where the government exercises its authority over the private body. In both instances, the government uses a private body as proxy to effectuate one of the types of financial contributions listed in paragraphs (i) through (iii). It may be difficult to identify precisely, in the abstract, the types of government action that constitute entrustment or direction and those that do not.... In most cases, one would expect entrustment or direction of a private body to involve some form of threat or inducement, which could, in turn, serve as evidence of entrustment or direction.[48]

The use of private intermediaries poses more of a challenge for Panels as they have to analyse how the seemingly private behaviour can be attributed to a government agency, which will not necessarily be keen to share that relationship with the rest of the world. In its report on *US—Countervailing Duty Investigation on DRAMs*, the Appellate Body recognized that factual findings will inevitably be often based on circumstantial evidence,[49] and reversed a Panel finding because the Panel had failed to examine the evidence in its totality.[50] However,

> government "entrustment" or "direction" cannot be inadvertent or a mere by-product of governmental regulation.[51] This is consistent with the Appellate Body's statement in US—Softwood Lumber IV that "not all government measures capable of conferring benefits would necessarily fall within Article 1.1(a)"; otherwise paragraphs (i) through

[48] *US—Countervailing Duty Investigation on DRAMs* (Appellate Body), para. 116.

[49] Ibid. para. 175.

[50] Ibid. para. 158.

[51] [Footnote 184 in the original]: 'In interpreting the phrase "payments... financed by virtue of governmental action" in Article 9.1(c) of the *Agreement on Agriculture*, the Appellate Body has stated that "[g]overnments are constantly engaged in regulation of different kinds in pursuit of a variety of objectives." It further explained that where regulation merely enables payments to occur, "the link between the governmental action and the financing of the payments is too tenuous for the 'payments' to be regarded as '*financed* by virtue of governmental action'... within the meaning of Article 9.1(c). Rather, there must be a tighter nexus between the mechanism or process by which the payments are *financed*, even if by a third person, and governmental action." *Canada—Dairy* (*Article 21.5—New Zealand and US*) (Appellate Body), para. 115 (original emphasis); see also *Canada—Dairy* (*Article 21.5—New Zealand and US II)* (Appellate Body), para. 131.

(iv) of Article 1.1(a) would not be necessary "because all government measures conferring benefits, per se, would be subsidies."[52]

2.1.5 Attributing financial contribution to a government

Pursuant to SCM Article 1.1 the financial contribution must be attributable to 'a government or any public body'. Thus, the drafters did not want to limit subsidies to state organs with central command and control authorities.[53] Rather, in a language almost reminiscent of American soul music, 'any' public body will do.[54] The Appellate Body, in a politically sensitive dispute, analysed the question in forty paragraphs (filling almost twenty pages) and apparently gave less relevance to the word 'any' than we would do:

> A public body within the meaning of Article 1.1.(a)(1) of the *SCM Agreement* must be an entity that possesses, exercises or is vested with governmental authority. Yet, just as no two governments are exactly alike, the precise contours and characteristics of a public body are bound to differ from entity to entity, State to State, and case to case. Panels or investigating authorities confronted with the question of whether conduct falling within the scope of Article 1.1.(a)(1) is that of a public body will be in a position to answer that question only by conducting a proper evaluation of the core features of the entity concerned, and its relationship with government in the narrow sense.
>
> . . . We do not, for example, consider that the absence of an express statutory delegation of authority necessarily precludes a determination that a particular entity is a public body. What matters is *whether* an entity is vested with authority to exercise governmental functions, rather than *how* that is achieved. There are many different ways in which government in the narrow sense could provide entities with authority. Accordingly, different types of evidence may be relevant to showing that such authority has been bestowed on a particular entity. Evidence that an entity is, in fact, exercising governmental functions may serve as evidence that it possesses or has been vested with governmental authority, particularly where such evidence points to a sustained and systematic practice. It follows, in our view, that evidence that a government exercises meaningful control over an entity and its conduct may serve,

[52] *US—Countervailing Duty Investigation on DRAMs* (Appellate Body), para. 114; cf. also *Canada—Dairy (Article 21.5—New Zealand and US II)* (Appellate Body), para. 128 (in particular fn. 113) and *Japan—DRAMs (Korea)* (Appellate Body), para. 138.

[53] cf. *Canada—Dairy* (Appellate Body), para. 97: 'The essence of "government" is . . . that it enjoys the effective power to "regulate", "control" or "supervise" individuals, or otherwise "restrain" their conduct, through the exercise of lawful authority. This meaning is derived, in part, from the *functions* performed by a government and, in part, from the government having the *powers* and *authority* to perform those functions. A "government agency" is, in our view, an entity which exercises powers vested in it by a "government" for the purpose of performing functions of a "governmental" character, that is, to "regulate", "restrain", "supervise" or "control" the conduct of private citizens. As with any agency relationship, a "government agency" may enjoy a degree of discretion in the exercise of its functions.'

[54] Solomon Burke, 'Make Do With What You Got', Label: Shout! Factory, 2005; no such reference appears in *US—Anti-Dumping and Countervailing Duties (China)* (Appellate Body), para. 285, where the term is very carefully dissected, as usual with the benefit of this publisher's dictionary; but see for a similar interpretation of the word any *US—Softwood Lumber IV* (Appellate Body), para. 91 *et seq.*

in certain circumstances, as evidence that the relevant entity possesses governmental authority and exercises such authority in the performance of governmental functions.[55]

2.1.6 *Income or price support in the sense of GATT 1994 Article XVI*

Pursuant to Article 1.1(a)(2) 'any form of income or price support in the sense of Article XVI of GATT 1994' may be a suitable substitute for a financial contribution. So far, the most authoritative definition has come from the Panel in *China—GOES*.[56]

2.2 A benefit conferred

A financial contribution (or income or price support) is only a subsidy to the extent that 'a benefit is thereby conferred', SCM Article 1.1(b). This is the case, when and if the financial contribution has made 'the recipient "better off" than it would otherwise have been, absent that contribution'.[57] However, a 'financial contribution' is not tantamount to bestowing a 'benefit' to a recipient; whereas the former examination takes place from the perspective of the donor, the latter's examination takes place from the perspective of the recipient.[58] Unless both prerequisites are met, there is no room for SCM disciplines:

> [I]f the financial contribution is not provided by the government (or directed or entrusted by the government), it is of no concern to us. If the financial contribution is provided (or directed or entrusted) by the government but still does not confer an advantage over what was available on the market, there is no need to discipline such government behaviour which lacks a trade distorting potential.[59]

[55] *US—Anti-Dumping and Countervailing Duties (China)* (Appellate Body), paras. 317–18.

[56] *China—GOES* (Panel):

> 7.84 On the one hand, the phrase 'any . . . price support' under Article 1.1(a)(2) of the SCM Agreement is broad and, on its face, could be read to include any government measure that has the effect of raising prices within a market. . . .
>
> 7.85 However, . . . a more narrow interpretation is appropriate. Under Article 1.1(a)(1)(i)–(iv), the existence of each of the four types of financial contribution is determined by reference to the action of the government concerned, rather than by reference to the effects of the measure on a market. This is consistent with the panel's interpretation of 'financial contribution' in *US—Export Restraints,* which the Appellate Body concurred with in *US—Countervailing Duty Investigation on DRAMs* . . . Reading the term 'price support' in this context, it is our view that it does not include all government intervention that may have an effect on prices, such as tariffs and quantitative restrictions. In particular, it is not clear that Article 1.1(a)(2) was intended to capture all manner of government measures that do not otherwise constitute a financial contribution, but may have an indirect effect on a market, including on prices. The concept of 'price support' also acts as a gateway to the SCM Agreement, and it is our view that its focus is on the nature of government action, rather than upon the effects of such action. Consequently, the concept of 'price support' has a more narrow meaning than suggested by the applicants, and includes direct government intervention in the market with the design to fix the price of a good at a particular level, for example, through purchase of surplus production when price is set above equilibrium. . . .

[57] *Canada—Aircraft* (Appellate Body), para. 157, confirmed by *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 662.

[58] *EC—Countervailing Measures on DRAM Chips* (Panel), para. 7.212.

[59] Ibid. para. 7.175.

For a benefit to be demonstrated, a complainant needs to show that a recipient obtained an advantage, which it could not have obtained in the marketplace:

> [T]he focus of the inquiry under Article 1.1(b) of the *SCM Agreement* should be on the recipient and not on the granting authority. The ordinary meaning of the word "confer", as used in Article 1.1(b), bears this out. "Confer" means, *inter alia*, "give", "grant" or "bestow". The use of the past participle "conferred" in the passive form, in conjunction with the word "thereby", naturally calls for an inquiry into what was conferred on the recipient. Accordingly, we believe that Canada's argument that "cost to government" is one way of conceiving of "benefit" is at odds with the ordinary meaning of Article 1.1(b), which focuses on the recipient and not on the government providing the "financial contribution".[60]

There is, however, a direct linkage between financial contribution and benefit: If no contribution took place, no benefit can result either.

With regard to the determination of benefits, Panels and the Appellate Body have relied on SCM Article 14 as the relevant context for the interpretation of benefit under Article 1.1(b),[61] despite the fact that this provision serves in the context of countervailing duties investigations to determine the amount of the subsidy in terms of the benefit to the recipient. In constant jurisprudence, Panels and the Appellate Body hold that Article 14, despite being an integral part of the provisions on CVD investigations (which determine whether the CVD is compatible with SCM Articles 10, 32, and GATT Article VI), is relevant context pursuant to VCLT Articles 31 and 32 for the interpretation of SCM Article 1.1(b).[62] SCM Article 14 reads in relevant parts:

> (a) government provision of equity capital shall not be considered as conferring a benefit, unless the investment decision can be regarded as inconsistent with the usual investment practice. . . .
> (b) a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan. . . .
> (c) a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. . . .

[60] *Canada—Aircraft* (Appellate Body), para. 154; the Arbitrators' report in *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)*, para. 3.60, explained that 'it is appropriate to calculate the amount of the subsidy on the basis of the benefit conferred by the loan. . . . [I]n such a case, the amount of the subsidy should correspond to the difference between the amount [the recipient] pays on the loan from [the subsidizer] and the amount [the recipient] would pay on a comparable commercial loan which that company could actually obtain on the market.'

[61] *Canada—Aircraft* (Appellate Body), para. 155; *EC and certain member States—Large Civil Aircraft* (Appellate Body), paras. 972–5; *Canada—Renewable Energy* (Appellate Body), para. 5.163.

[62] cf. *Canada—Aircraft* (Appellate Body), para. 155; *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 703; *Canada—Renewable Energy* (Appellate Body), para. 5.163; *EC—Countervailing Measures on DRAMs Chips* (Panel), para. 7.173 *et seq.*

(d) the provision of goods or services or purchase of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration, or the purchase is made for more than adequate remuneration. The adequacy of remuneration shall be determined in relation to prevailing market conditions. . . .

In *US—Softwood Lumber III*, the Panel had to deal with the compatibility of a US method with the guidelines enshrined in SCM Article 14. The United States had used the prices in their own market as a benchmark to establish whether Canada was subsidizing softwood lumber production. The reliance on US prices was explained by the difficulty in establishing a reliable Canadian price point, as required, in principle, by SCM Article 14(a). Canadian private stumpage prices were said to be distorted and suppressed by the very large number of government sales. In a manner reminiscent of the use of another market for the determination of 'likeness' in *Japan—Alcoholic Beverages II*, the United States claimed that the trade-distorting potential of the Canadian government's provision of a good could be identified only by reference to an independent market price, that is, unaffected by the very trade distortion the test is designed to identify.[63] However, in the Panel's view,

> the "prevailing market conditions" of Article 14 (d) SCM Agreement do not refer to a theoretical market free of government interference as the US seems to be suggesting. Article 14 (d) SCM Agreement provides that the "prevailing" market conditions in the country of provision of the goods are to form the basis for the comparison. The ordinary meaning of the term "prevailing" market conditions is the market conditions "*as they exist*" or "*which are predominant*". . . . [T]he text of Article 14 (d) SCM Agreement does not in any way require the "market" conditions to be those of a hypothetical undistorted or perfectly competitive market.[64] (Emphasis in the original.)

In *US—Softwood Lumber IV* the Appellate Body took a divergent view:

> [T]he starting-point, when determining adequacy of remuneration [pursuant to SCM Article 14(d)], is the prices at which the same or similar goods are sold by private suppliers in arm's length transactions in the country of provision. This approach reflects the fact that private prices in the market of provision will generally represent an appropriate measure of the "adequacy of remuneration" for the provision of goods. However, this may not always be the case.[65]

In the Appellate Body's view, the due process obligation to create a fair and comprehensive picture of the situation demands that Panels 'look outside the box' that is the home market, in order to allow a fair assessment of the matter, provided the status quo is distorted.

[63] It should be noted that a prior Panel report dealing with the same issue (*US—Softwood Lumber II*) had already dismissed the same argument because of its inconsistency with the guideline embedded in SCM Art. 14(d).

[64] Ibid. para. 7.50.

[65] *US—Softwood Lumber IV* (Appellate Body), para. 90.

> [W]hile requiring investigating authorities to calculate benefit "in relation to" prevailing conditions in the market of the country of provision, Article 14(d) permits investigating authorities to use a benchmark other than private prices in that market. When private prices are distorted because the government's participation in the market as a provider of the same or similar goods is so predominant that private suppliers will align their prices with those of the government-provided goods, it will not be possible to calculate benefit having regard exclusively to such prices.[66]

The Appellate Body then presents potential parameters to be considered:

> [A]lternative methods for determining the adequacy of remuneration could include proxies that take into account prices for similar goods quoted on world markets, or proxies constructed on the basis of production costs. We emphasize, however, that where an investigating authority proceeds in this manner, it is under an obligation to ensure that the resulting benchmark relates or refers to, or is connected with, prevailing market conditions in the country of provision, and must reflect price, quality, availability, marketability, transportation and other conditions of purchase or sale, as required by Article 14(d).[67]

2.2.1 The 'private investor test' as a starting point

As discussed earlier, the benefit for the recipient can only be determined by comparing the status quo with the counterfactual of a competitive market. This comparison with a market benchmark is indispensable, 'regardless of whether the advantage needs to be precisely quantified or not.'[68] In *Canada—Aircraft*, the Appellate Body explained:

> [T]here can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.[69]

This entails the question: what is the relevant market and how to define it? Readers should be aware that this is a question that will be asked often in this chapter. Here, we discuss the question whether, under market conditions, the recipient was better off than she would otherwise have been. We shall examine alleged harmful effects in the market; there too, difficult questions of market definition may arise. Note, that the understanding that the SCM—as well as most favoured nation (MFN) and national treatment (NT) principles—serve to limit the state's influence to distort competitive

[66] Ibid. para. 101. [67] Ibid. para. 106.
[68] *Canada—Renewable Energy* (Appellate Body), para. 5.164.
[69] *Canada—Aircraft* (Appellate Body), para. 157; *US—Lead and Bismuth II* (Appellate Body), para. 68; cf. also *Canada—Autos* (Panel), para. 10.165; *US—Countervailing Measures on Certain EC Products* (Appellate Body), paras. 108 *et seq*., 113–14 and *US—Upland Cotton* (Appellate Body), para. 731.

relationships is a leitmotiv of current Appellate Body jurisprudence, manifested inter alia in the excerpt above. 'Competitive relationships' and 'markets' are inseparable as concepts, one defines the other: The only methodologically sound way to determine the existence of a benefit is the comparison with the prices of goods and services in the relevant market, that is, under conditions of competition. One of the more recent efforts to establish the legal parameters for defining markets in the context of SCM 'benefit determination' can be found in the twin cases of *Canada—Renewable Energy* and *Canada—Feed-In Tariff Program*. There, the Appellate Body emphasized that 'the definition of the relevant market is central to, and a prerequisite for' determining whether a benefit was conferred pursuant to SCM Article 1.1(b).[70]

> Demand-side substitutability—that is, when two products are considered substitutable by consumers—is an indispensable, but not the only relevant, criterion to consider when assessing whether two products are in a single market. Rather, a consideration of substitutability on the supply-side may also be required. For example, evidence on whether a supplier can switch its production at limited or prohibitive cost from one product to another in a short period of time may also inform the question of whether two products are in a single market.[71]

Thus, Panels have to take into account both all demand-side factors and all supply-side factors. We reproduce a significant part of the relevant discussion in *Canada—Renewable Energy* to illustrate that this demand on future Panels is significant, indeed:

> 5.170 [W]e observe that, on the one hand, the fact that electricity is physically identical, regardless of how it is generated, suggests that there is high demand-side substitutability between electricity generated through different technologies. On the other hand, however, there are additional factors that may be used to differentiate on the demand-side.... Factors such as the type of contract, the size of the customer, and the type of electricity generated (base-load versus peak-load) may differentiate the market.[72]
>
> 5.172 Had the Panel undertaken an analysis of demand-side and supply-side factors, and in particular supply-side factors, the significance of government intervention in the electricity market to the definition of the relevant market would have become evident. Such an analysis would have permitted the Panel to reach different conclusions, particularly if, as it explained later in its Reports, it was of the view that the competitive wholesale electricity market was not the appropriate focus of the benefit analysis in these disputes.
>
> 5.178 ... [N]ot only should the Panel have defined the relevant market at the outset of its benefit analysis, but, in its analysis of the relevant market, it should also have

[70] *Canada—Renewable Energy* (Appellate Body), para. 5.169.

[71] In ibid. para. 5.171 the excerpt given here is fully reproduced from *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1121.

[72] [Footnote 676 in the original:] For instance, certain customers, due to their size, operation, and contract, may require electricity at certain times of the day or night, thus increasing demand for base-load or peak-load electricity. Large industrial-sized customers are likely to be able to negotiate more favourable contract conditions than will be offered to household customers. The market may also be differentiated by contract type—i.e. its duration or whether prices are hedged or flexible.

> considered that in Ontario the government definition of the energy supply-mix for electricity shapes the markets in which generators of electricity through different technologies compete.... Had the Panel more thoroughly scrutinized supply-side factors, it would have come to the conclusion that, even if demand-side factors weigh in favour of defining the relevant market as a single market for electricity generated from all sources of energy, supply-side factors suggest that important differences in cost structures and operating costs and characteristics among generating technologies prevent the very existence of windpower and solar PV generation, absent government definition of the energy supply-mix of electricity generation technologies. This, in turn, would have lead the Panel to conclude that the benefit comparison under Article 1.1(b) should not be conducted within the competitive wholesale electricity market as a whole, but within competitive markets for wind- and solar PV-generated electricity, which are created by the government definition of the energy supply-mix.

According to the Appellate Body, the definition of a certain supply-mix by the government cannot, as such, be 'considered as conferring a benefit' within the meaning of SCM Article 1.1(b).[73] To take a step back: The Appellate Body insulated a reasonable government measure from an SCM-based attack by accepting a market definition less defined by demand and supply and more by normative consideration influencing demand and supply. As the SCM does not contain a general exception comparable to Article XX GATT, any other decision would have raised the question whether Article XX GATT is applicable, or whether there is a 'sleeping beauty' provision in the SCM waiting to be discovered in the SCM which has the same effect. All of these issues were avoided, and what is arguably a legitimate and reasonable state measure was found to be WTO-compatible.

2.2.2 Identity of the recipient and the issue of 'pass through' of subsidies

In *Canada—Aircraft*, the Appellate Body emphasized a seemingly obvious thought:

> A "benefit" does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person, natural or legal, or a group of persons, has in fact received something. The term "benefit", therefore, implies that there must be a recipient.[74]

However, what seems clear enough at first glance may become a complicated issue when the recipient of a contribution is not identical with the ultimate beneficiary: this may be the case if financial contributions are being paid to company A with the goal of benefiting company B, for example by making A buy products from B (downstream) or by A selling products to B at a favourable price (upstream). In *Softwood Lumber IV*, the Appellate Body opined:

> Thus, for a potentially countervailable subsidy to exist, there must be a financial contribution by the government that confers a benefit to a *recipient*. Where a subsidy

[73] *Canada—Renewable Energy* (Appellate Body), para. 5.175.
[74] *Canada—Aircraft* (Appellate Body), para. 154.

is conferred on input products, and the countervailing duty is imposed on processed products, the initial recipient of the subsidy and the producer of the eventually countervailed product, may not be the same. In such a case, there is a *direct recipient* of the benefit—the producer of the *input* product. When the input is subsequently processed, the producer of the *processed product* is an *indirect recipient* of the benefit—provided it can be established that the benefit flowing from the input subsidy is passed through, at least in part, to the processed product. Where the input producers and producers of the processed products operate at *arm's length*, the pass-through of input subsidy benefits from the direct recipients to the indirect recipients downstream cannot simply be presumed; it must be established by the investigating authority. In the absence of such analysis, it cannot be shown that the essential elements of the subsidy definition in Article 1 are present in respect of the *processed product*. In turn, the right to impose a countervailing duty on the processed product for the purpose of offsetting an input subsidy, would not have been established in accordance with Article VI:3 of the GATT 1994, and, consequently, would also not have been in accordance with Articles 10 and 32.1 of the *SCM Agreement*.[75]

A related issue is the transfer of the economic entity that had received the benefit to a new owner, and the ensuing question whether a sale at arm's length has consummated the benefit. In its report on *US—Lead and Bismuth II*, the Appellate Body dealt with a challenge by the European Community against CVDs imposed by the United States on privatized EC operators and took the view that the market price paid by the new owners had 'exhausted' any subsidy previously granted:

[T]he Panel made factual findings that [the new owner] paid fair market value for all the productive assets, goodwill, etc., they acquired from [the previous owner] and subsequently used in the production of leaded bars imported into the United States in 1994, 1995 and 1996. We, therefore, see no error in the Panel's conclusion that, in the specific circumstances of this case, the "financial contributions" bestowed on [the previous owner] between 1977 and 1986 could not be deemed to confer a "benefit" on [the new owner].[76]

In *US—Countervailing Measures on Certain EC Products*, the Appellate Body fine-tuned its position on this issue, specifying that even if a privatization occurred at arm's length, the benefits conferred would not necessarily be wiped out. In its view, a market price paid only creates the (rebuttable) presumption that the effects of a subsidy previously paid have been exhausted.

Privatization at arm's length and for fair market value *may* result in extinguishing the benefit. Indeed, we find that there is a rebuttable presumption that a benefit ceases to exist after such a privatization. Nevertheless, it does not *necessarily* do so.[77]

[75] *US—Softwood Lumber IV* (Appellate Body), para. 143.

[76] *US—Lead and Bismuth II* (Appellate Body), para. 68; see also *Canada—Aircraft* (Appellate Body), para. 155.

[77] *US—Countervailing Measures on Certain EC Products* (Appellate Body), para. 127. This seems to be the current state of play. In the subsequent report on *US—Softwood Lumber IV*, the Panel took the view that irrespective of the price paid, an investigation is necessary to determine whether a benefit continues to exist. The Appellate Body confirmed this: *US—Softwood Lumber IV* (Appellate Body), para. 143. The pass-

In *EC and certain member States—Large Civil Aircraft*, the EU had argued that 'sales of shares between private entities, and sales conducted in the context of partial privatizations' had eliminated all or part of past subsidies.[78] In support of this proposition, it had invoked the Appellate Body reports in *US—Lead and Bismuth II*[79] and US—*Countervailing Measures on Certain EC Products*.[80]

Rightly, the Appellate Body highlighted that both reports only 'stand for the proposition that a presumption of extinction arises where there is a full privatization'[81] which involves sales at fair market value, at arm's length, and a subsequent full transfer of ownership and control. In *Airbus*, the Appellate Body had to examine to what extent a partial privatization and private-to-private sales had an equivalent effect on the lifespan of the subsidies in question. However, the three Appellate Body members could not agree on one consolidated position and chose to offer insights into their personal thinking:

(a) Noting that the Appellate Body has previously ruled in privatization cases that a full privatization, conducted at arm's length and for fair market value involving a complete or substantial transfer of ownership and control, "extinguishes" prior subsidies, one member is of the view that this rule does not apply to partial privatizations or to private-to-private sales.

(b) One member noted that, as discussed earlier, the Appellate Body ruled in *US—Countervailing Measures on Certain EC Products* that . . . full privatization at arm's length and for fair market value *may* result in extinguishing the benefit received from the non-recurring financial contribution bestowed upon a state-owned firm. . . . This Member considers the *rationale* underlying the Appellate Body's case law on full privatization in the context of Part V of the *SCM Agreement* equally to apply in situations of partial privatization and private-to-private transactions and in the context of Part III of the *SCM Agreement*. However, this Member also notes that, as the Appellate Body emphasized in *US—Countervailing Measures on Certain EC Products*, there is "no inflexible rule" that a "benefit" derived from pre-privatization financial contributions expires following privatization at arm's length and for fair-market value. Rather, . . . "[i]t depends on the facts of each case." An important question in this context is to what extent the partial privatization or private-to-private transactions

through cases and the non-recurring subsidies cases are not factually identical. The former cases concern countervailing of *final* products that have used subsidized *inputs*. In both scenarios, however, the following question arises: Does a market price exhaust or 'sterilize' prior subsidization?

[78] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 724.

[79] *US—Lead and Bismuth II* (Appellate Body); see Gene M. Grossman and Petros C. Mavroidis, 'United States—Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom: Here Today, Gone Tomorrow? Privatization and the Injury Caused by Non-Recurring Subsidies' in Henrik Horn and Petros C. Mavroidis, eds., *The WTO Case Law of 2001* (Cambridge University Press, 2003) 170–200; see also Sherzod Shadikhodjaev, 'How to Pass a Pass-Through Test: The Case of Input Subsidies' (2012) *Journal of International Economic Law,* Vol. 15, 621–46.

[80] *US—Countervailing Measures Concerning Certain EC Products (Article 21.5—EC)* (Panel), paras. 7.93, 7.108.

[81] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 725.

resulted in a transfer of control to new owners who paid fair market value for shares in the company.

(c) One member of the Division, though affirming the general test that an extinction of benefit is to be determined upon a consideration of all relevant facts, entertains no small measure of doubt that an acquisition of shares, concluded at arm's length and for fair market value, constitutes relevant circumstances warranting the conclusion that an extinction of benefit has taken place. A subsidy granted to a recipient company contributes to the net asset value of that company. The value of that asset permits the recipient to enjoy an enhanced stream of future earnings over the life of the asset. The asset is the property of the recipient. The recipient's shareholders enjoy the right to the dividends that may be declared by the recipient and to any capital gains that arise from the enhanced earnings attributable to the recipient. When shares change hands on an arm's length basis and for fair market value, the buyer pays a price that, in the estimation of the buyer, places a proper value on the future earnings of the recipient. Those earnings derive from all the assets of the recipient, including the benefit of any subsidy paid to the recipient. One shareholder may not accurately value or properly manage the assets of the recipient. Precisely for this reason, sales of shares take place: the buyer believes that the assets, properly managed, will be worth more over time than the price paid, and the seller believes the opposite. Time will tell who is correct. The central point is that a sale of shares, whether or not it conveys control, transfers rights in the shares to a new owner. The assets of the company, to which the shares attach, do not change at all. Nor could it be otherwise, because the buyer would then not acquire the full benefit of the bargain: the buyer would pay for an asset (the subsidy) that had in the very sales transaction been "extinguished". Shares in listed companies are traded on stock exchanges with great frequency and without any fear that sales on the market diminish the underlying value of the assets owned by these companies. The changing price of listed securities reflects the different valuations that buyers and sellers place upon companies and their underlying assets. However, nothing about these trades extracts the value of any asset, including the benefit of any subsidy granted. That subsidy continues to benefit the recipient, even if the ownership of the recipient's shares changes from one day to another. Given that the Appellate Body in this case does not need to come to any final view on the issue of extinction in the context of a partial privatization or private-to-private sales, these matters do not require more definitive determination.[82]

The Appellate Body took the liberty not to decide the issue as it was of the opinion that the file was not in a state that would have allowed the Appellate Body to complete the

[82] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 726, footnotes omitted; note the similarity between position (c) and Gene M. Grossman and Petros C. Mavroidis, 'Privatization and the Injury Caused by Non-Recurring Subsidies' in Henrik Horn and Petros C. Mavroidis, eds., *The WTO Case Law of 2001* (Cambridge University Press, 2003), n. 79 at 170–200 and Gene M. Grossman and Petros Mavroidis, 'Recurring Misunderstandings of Non Recurring Subsidies' in Henrik Horn and Petros C. Mavroidis, eds., *The WTO Case Law of 2002, The American Law Institute Reporters' Studies* (Cambridge University Press, 2005) 78–87.

legal analysis. This is highly regrettable; more legal predictability and certainty on this point would have been most welcome.

2.2.3 *Duration of benefits—the life of a subsidy*

EC and certain member States—Large Civil Aircraft also gave occasion to rethink the issue of 'life of a subsidy', or in other words the duration of the benefits of a subsidy: How long does a financial contribution benefit the recipient? While the Appellate Body flatly rejected the EU's proposition 'that there must be "present benefit" during the reference period',[83] the proposition that a subsidy has a 'life' is explicitly recognized:

> [It] may come to an end, either through the removal of the financial contribution and/or the expiration of the benefit. . . . where it is so argued, a panel must assess whether there are "intervening events" that occurred after the grant of the subsidy that may affect the projected value of the subsidy as determined under the *ex ante* analysis. Such events may be relevant to an adverse effects analysis because they may affect the link that a complaining party is seeking to establish between the subsidy and its alleged effects.[84]

Focusing on the nexus between subsidy and its alleged effect the Appellate Body explained:

> At the time of the grant of a subsidy, the subsidy will necessarily be projected to have a finite life and to be utilized over that finite period. . . . [A] subsidy provided accrues and diminishes over time, and will have a finite life. The adverse effects analysis under Article 5 is distinct from the "benefit" analysis under Article 1.1(b) of the *SCM Agreement* and there is consequently no need to re-evaluate under Article 5 the amount of the benefit conferred pursuant to Article 1.1(b). Rather, an adverse effects analysis under Article 5 must consider the trajectory of the subsidy as it was projected to materialize over a certain period at the time of the grant.[85]

Thus, one may visualize the lifespan of the subsidy as such and its effects as parallel curve graphs, which are not identical but subsequent and may be partially overlapping.

2.3 Specificity

In order to separate the provision of good government and support for the economy in general (for example, good schools, great universities, excellent transportation infrastructure, and a peaceful society), SCM Article 1.2 subjects subsidies pursuant to SCM Article 1.1 'to the provisions of Part II or . . . to the provisions of Part III or V only if such a subsidy is specific', pursuant to SCM Article 2. Thus 'specificity' of the subsidy is a condition for both unilateral and multilateral actions against any subsidy. Three types of subsidies are a priori categorized as 'specific', without any need to examine in detail

[83] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 711. As a consequence of the EU's mistaken interpretation of SCM Art. 5 (and 6) it 'conflate[d] present adverse *effects*, which must be demonstrated under Article 6.3, with present *subsidization*, which need not' (ibid. para. 712).
[84] Ibid. para. 709. [85] Ibid.

whether they meet the general specificity requirements: (1) subsidies to certain companies within a designated region pursuant to SCM Article 2.2;[86] and two categories that will be discussed further later, namely (2) local content subsidies pursuant to SCM Article 2.3; and (3) export subsidies pursuant to SCM Article 2.3.
SCM Article 2.1 reads in relevant parts:

> In order to determine whether a subsidy . . . is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:
>
> (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.
>
> (b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or condition[87] governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.
>
> (c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.[88] In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation.

At the time of writing, several Appellate Body reports have engaged in interpreting the specificity requirements. The most difficult factual questions had to be tackled in the two *Large Civil Aircraft*[89] cases, which the United States and the EU initiated against subsidies paid to Boeing and Airbus respectively. It is easy to understand why specificity questions were so important. Both the United States and the EU subsidies are couched in a regulatory environment which supports pertinent high-technology

[86] cf. *US—Anti-Dumping and Countervailing Duties (China)* (Panel), para. 9.135; *EC and certain member States—Large Civil Aircraft* (Panel), para. 7.1223.

[87] '[Footnote 2 in the original] Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.'

[88] '[Footnote 3 in the original] In this regard, in particular, information on the frequency with which applications for a subsidy are refused or approved and the reasons for such decisions shall be considered.'

[89] *US—Large Civil Aircraft* (2nd complaint) (Panel), paras. 7.192–7.211, 7.560–7.567, 7.590–7.592, 7.1045–7.1049, and 7.1195–7.1196; *EC and certain member States—Large Civil Aircraft* (Appellate Body), paras. 937–52; *EC and certain member States—Large Civil Aircraft* (Panel), paras. 7.497, 7.892–7.935, 7.1097, 7.1134, 7.1191, 7.1290, 7.1301, 7.1379, 7.1413, and 7.1504–7.1607.

endeavours; also, the federal structure of both players, the national security aspects which were sometimes more, sometimes less visible, and, lastly, some old-fashioned efforts on both sides to hide the extent of the subsidies for a variety of reasons rendered the question of specificity crucial.

However, the Appellate Body's textbook introduction to its Article 2 specificity analysis is to be found in *US—Anti-Dumping and Countervailing Duties*.[90] According to the Appellate Body, SCM Article 2 is characterized by a two-tier structure: the first tier is the 'chapeau' of Article 2.1. It frames the 'central inquiry as a determination as to whether a subsidy is specific to "certain enterprises" within the jurisdiction of the granting authority'.[91] The second tier encompasses the scenarios enumerated in SCM Article 2.1 (a) to (c). Pursuant to the Appellate Body's reading, the SCM's choice of words regarding the legal concepts explored in its subparagraphs—namely 'principles', rather than 'rules',

> suggests that subparagraphs (a) through (c) are to be considered within an analytical framework that recognizes and accords appropriate weight to each principle. Consequently, the application of one of the subparagraphs of Article 2.1 may not by itself be determinative in arriving at a conclusion that a particular subsidy is or is not specific.[91a]

The Appellate Body emphasizes the primacy of the first tier, and declares the principles to be somewhat explanatory of the general principle. Thus, Panels will have to engage in a holistic weighing[92] of the different 'principles' of SCM Article 2.1:

> 369. Notwithstanding the fact that the principles under subparagraphs (a) and (b) may point to opposite results, there may be situations in which assessing the eligibility for a subsidy will give rise to indications of specificity and non-specificity as a result of the application of Article 2.1(a) and (b). This is because Article 2.1(a) identifies circumstances in which a subsidy is specific, whereas Article 2.1(b) establishes circumstances in which a subsidy shall be regarded as non-specific. We can conceive, for example, of situations in which an initial indication of specificity under Article 2.1(a) may need to be considered further if additional evidence demonstrates that the subsidy in question is available on the basis of objective criteria or conditions within the meaning of Article 2.1(b). This therefore suggests that, where the eligibility requirements of a measure present some indications pointing to subparagraph (a) and certain others pointing to subparagraph (b), the specificity analysis must accord appropriate consideration to both principles.
>
> 370. . . . Since an "appearance of non-specificity" under Article 2.1(a) and (b) may still result in specificity in fact under Article 2.1(c) of the *SCM Agreement*, this reinforces our view that the principles in Article 2.1 are to be interpreted together.

[90] *US—Anti-Dumping and Countervailing Duties (China)* (Appellate Body), paras. 366–78 and 380–401.

[91] Ibid. para. 366. [91a] Ibid.

[92] *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 754: 'The Appellate Body has cautioned against examining specificity on the basis of the application of a particular subparagraph of Article 2.1 "when the potential for application of other subparagraphs is warranted in the light of the nature and content of measures challenged in a particular case". Thus, following an assessment under Article 2.1 (a), a panel must also consider whether Article 2.1(b) and/or Article 2.1(c) are applicable.'

> 371. Accordingly, we consider that a proper understanding of specificity under Article 2.1 must allow for the concurrent application of these principles to the various legal and factual aspects of a subsidy in any given case. Yet, we recognize that there may be instances in which the evidence under consideration unequivocally indicates specificity or non-specificity by reason of law, or by reason of fact, under one of the subparagraphs, and that in such circumstances further consideration under the other subparagraphs of Article 2.1 may be unnecessary.[93]

As might be expected, the devil is in the detail. In *US—Large Civil Aircraft* (2nd complaint), the Appellate Body had to determine the highly complex legislative fundament for payments to Boeing.

> [I]t requires careful scrutiny of the relevant legislation—whether set out in one or several instruments—or the pronouncements of the granting authority(ies) to determine whether the subsidies are provided pursuant to the same subsidy scheme. Another factor that may be considered is whether there is an overarching purpose behind the subsidies. Of course, this overarching purpose must be something more concrete than a vague policy of providing assistance or promoting economic growth. Once the proper subsidy scheme is identified, then the question is whether that subsidy is explicitly limited to "certain enterprises", defined in the chapeau of Article 2.1 as "an enterprise or industry or group of enterprises or industries". To be clear, such examination must seek to discern from the legislation and/or the express acts of the granting authority(ies) which enterprises are eligible to receive the subsidy and which are not. This inquiry focuses not only on whether the subsidy was provided to the particular recipients identified in the complaint, but focuses also on all enterprises or industries eligible to receive that same subsidy. Thus, even where a complaining Member has focused its complaint on the grant of a subsidy to one or more enterprises or industries, the inquiry may have to extend beyond the complaint to determine what other enterprises or industries also have access to that same subsidy under that subsidy scheme.[94]

SCM Article 2 does not provide the reader with a definition of the terms 'enterprise or industry or group of enterprises or industries'. However, SCM Article 16 provides a definition of the term 'domestic industry' as 'the domestic producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products'.[95] In *US—Upland Cotton*, the Panel opined that 'an industry, or group of "industries", may be generally referred to by the type of products they produce', but that 'the breadth of this concept of "industry" may depend on several factors in a given case'.[96] While conceding that

[93] *US—Anti-Dumping and Countervailing Duties (China)* (Appellate Body), paras. 369–71.

[94] *US—Large Civil Aircraft (2nd complaint)* (Appellate Body), paras. 752–3.

[95] Whether a product is 'like', is to be determined pursuant to four criteria established in *Japan—Alcoholic Beverages II* (Appellate Body), 20 *et seq.*; *EC—Asbestos* (Appellate Body), paras. 101–3.

[96] *US—Upland Cotton* (Panel), para. 7.1142.

this jurisprudence 'involves "a certain amount of indeterminacy at the edges"',[97] the Appellate Body agreed with this concept:

> The above suggests that the term "certain enterprises" refers to a single enterprise or industry or a class of enterprises or industries that are known and particularized. We . . . agree . . . with the panel in *US—Upland Cotton* that any determination of whether a number of enterprises or industries constitute "certain enterprises" can only be made on a case-by-case basis.[98]

3. Prohibited Subsidies ('Red Light Subsidies')

At least since the beginning of the Uruguay Round of Trade Negotiations, subsidies were categorized according to the three colours of a traffic light (red, yellow, and green). As WTO subsidies law stands, however, subsidies are either prohibited pursuant to SCM Article 3 or actionable according to SCM Article 5. This binary choice is the consequence of non-actionable (i.e. 'green') subsidies pursuant to SCM Article 8 having been included in the SCM on a provisional basis only. As the members could not agree on an extension, that safe haven provision has ceased to be applicable.[99] Recall that agricultural subsidies are regulated in the WTO Agreement on Agriculture (AoA), discussed in some detail in the previous chapter. The AoA provisions constitute *lex specialis* to the SCM provisions. SCM Article 3 reads in relevant parts:

> 3.1 Except as provided in the [AoA], the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;
>
> (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.
>
> 3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1 [footnotes omitted].

Note that the word 'prohibited' is rare indeed in WTO law. In fact, it appears in neither the GATT, the AoA, the TBT Agreement, or the SCM, other than in the context discussed here. What is it that made everyone agree that these types of subsidies should be plainly illegal (another word strictly avoided in the diplomatic world of the WTO, where 'WTO-incompatibility' is the strongest characterization of the internationally wrongful act to not abide by one's treaty obligations)?

[97] *US—Anti-Dumping and Countervailing Duties (China)* (Appellate Body), para. 373.

[98] Ibid., footnote omitted.

[99] cf. SCM Art. 31: 'The provision . . . of Article 8 shall apply for a period of five years, beginning with the date of entry into force of the WTO Agreement. Not later than 180 days before the end of this period, the Committee shall review the operation of [that] provision . . . , with a view to determining whether to extend [its] application . . . '.

As usual, the answer is multi-faceted. First, export subsidies were the bête noire for many developing countries, which were facing competitors having access to the state coffers. Worse, however, at a conceptual level, export subsidies are rather obviously incompatible with the very notion of fair and undistorted trade. The member using the export subsidies does so for the sole purpose of supporting its operators in their competition with operators from other members. This is a targeted intrusion into the interest sphere of all members with domestic industries producing like products. To give two examples: Boeing not only has to compete with a new company but also with the financial firepower of the world's biggest trading bloc. And, from the opposite perspective, Airbus is not just competing with the company that dominated the market for large civil aircrafts since half a century; in addition, it faces the threat emanating from the national security budget of the Pentagon. Subsidies contingent upon the use of domestic over imported goods are a variation on the same theme: all negotiated market openings come to naught, when the fellow member (who received corresponding trade benefits) nullifies all market access liberalizations by giving economic incentives not to buy from foreign sources.

3.1 Export subsidies

A subsidy is per se prohibited, without regard to its effect[100] pursuant to SCM Article 3, if it is (de jure or de facto) conditional upon export performance. An Illustrative List to the SCM (Annex I) offers a non-exhaustive list of prohibited export subsidies, which indicates twelve types of state aid conduct that the drafters of the SCM found inherently trade distorting and illegitimate:

(a) The provision . . . of direct subsidies . . . contingent upon export performance.

(b) Currency retention schemes or any similar practices . . .

(c) Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments.

(d) The provision . . . of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favourable than for provision of like or directly competitive products or services for use in the production of goods for domestic consumption . . .

(e) The full or partial exemption remission, or deferral specifically related to exports, of direct taxes or social welfare charges . . .

(f) The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption . . .

(g) The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the

[100] But note the third element of a de facto export subsidy pursuant to *Canada—Aircraft* (Appellate Body), paras. 169 and 173: 'actual or anticipated exportation or export earnings'.

production and distribution of like products when sold for domestic consumption.

(h) The exemption, remission or deferral of prior-stage cumulative indirect taxes on goods or services used in the production of exported products...

(i) The remission or drawback of import charges in excess of those levied on imported inputs that are consumed in the production of the exported product (making normal allowance for waste)...

(j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes...

(k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement...

In *Brazil—Aircraft (Article 21.5—Canada)*,[101] the Appellate Body clarified that a subsidy coming under the purview of the Illustrative List was *ipso facto* prohibited; a complainant need not show in detail that the general requirements of SCM Article 3.1 are met.

In contrast, if a support measure does not appear on the Illustrative List, the complainant will have to demonstrate that the subsidizing state 'either in law or in fact' made payment contingent on either exports or the use of domestic goods. In the jurisprudence of the Appellate Body and the Panels, contingent has been understood to mean 'conditional or dependent',[102] 'tied to' the export performance.[103]

In *Canada—Aircraft*, the Appellate Body discussed the different evidential standards required to demonstrate the existence of a de jure or a de facto export subsidy. It explained why, in its view, the latter was a more demanding standard in the following terms:

In our view, the legal standard expressed by the word "contingent" is the same for both *de jure* and *de facto* contingency. There is a difference, however, in what evidence may

[101] *Brazil—Aircraft (Article 21.5—Canada)* (Appellate Body), para. 59 *et seq.*

[102] *US—FSC (Article 21.5—EC)* (Appellate Body), para. 111; *Canada—Aircraft* (Appellate Body), para. 166; *US—Upland Cotton* (Appellate Body), para. 572.

[103] *US—Upland Cotton* (Appellate Body), para. 572.

be employed to prove that a subsidy is export contingent. *De jure* export contingency is demonstrated on the basis of the words of the relevant legislation, regulation or legal instrument. Proving *de facto* export contingency is a much more difficult task. There is no single legal document which will demonstrate, on its face, that a subsidy is "contingent . . . in fact . . . upon export performance." Instead, the existence of this relationship of contingency, between the subsidy and the export performance, must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case. . . .

We note that satisfaction of the standard for determining *de facto* export contingency set out in footnote 4 requires proof of three different substantive elements: first, "the *granting* of a subsidy"; second, "is . . . *tied to* . . . "; and third, "actual or anticipated exportation or export earnings".[104] (Italics and emphasis in the original.)

US—FSC (Article 21.5—EC) provides the understanding of the evidentiary standard associated with a proof that a de jure export subsidy has indeed occurred:

[F]or a subsidy to be *de jure* export contingent, the underlying legal instrument does not always have to provide *expressis verbis* that the subsidy is available only upon fulfilment of the condition of export performance. Such conditionality can also be derived by necessary implication from the words actually used in the measure.[105]

Mere knowledge of the beneficiary's exporting activities would, in the light of footnote 4 to the SCM,[106] not suffice for the de facto threshold to be met. Something more is required, the Appellate Body explained:

In any given case, the facts must "demonstrate" that the granting of a subsidy is *tied to* or *contingent upon* actual or anticipated exports. It does *not* suffice to demonstrate solely that a government granting a subsidy *anticipated* that exports would result.[107] (Italics in the original.)

The Appellate Body then cautioned:

The second sentence of footnote 4 precludes a panel from making a finding of *de facto* export contingency for the sole reason that the subsidy is "granted to enterprises which export". . . . The second sentence of footnote 4 is, therefore, a specific expression of the requirement in the first sentence to demonstrate the "tied to" requirement.[108]

[104] *Canada—Aircraft* (Appellate Body), paras. 167 and 169.

[105] *US—FSC (Article 21.5—EC)* (Appellate Body), para. 112; see also *Canada—Autos* (Appellate Body), para. 100.

[106] Footnote 4, which interprets the term *subsidies contingent in fact* used in SCM Art. 3.1, reads: 'This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.'

[107] *Canada—Aircraft* (Appellate Body), para. 171.

[108] *Canada—Aircraft* (Appellate Body), para. 173; cf. the Appellate Body report on *US—FSC (Article 21.5—EC)*, para. 112 citing prior relevant case law, provided its understanding of the evidentiary standard associated with a proof that a de jure export subsidy indeed occurred: 'We recall that in *Canada—Autos*, we stated: . . . a subsidy is contingent "in law" upon export performance when the existence of that condition can be demonstrated on the basis of the very words of the relevant legislation, regulation or other

In the *Airbus* report, the Appellate Body develops that body of law.[109] In no uncertain terms, it rejects a 'standard that requires anticipated exportation to be the reason for the granting of the subsidy'.[110] Stating explicitly that the standard for de facto export contingency is neither met 'by showing that anticipated exportation is the reason for granting the subsidy', nor by showing 'the subjective motivation of the granting government to promote the future export performance of the recipient',[111] it develops the notion that a subsidy must be 'geared to the promotion of exports' in order to be a prohibited export subsidy:

> Where a subsidy is alleged to be "in fact tied to . . . anticipated exportation", the relationship of conditionality . . . can be established by recourse to the following test: is the granting of the subsidy geared to induce the promotion of future export performance by the recipient?[112]

The report uses the new term 'geared to induce the promotion of future export performance' almost twenty times, indicating that its drafters wanted to let the world know that a new concept has been added to pre-existing case law. According to the Appellate Body, it means that

> the standard for *de facto* export contingency under Article 3.1(a) and footnote 4 of the *SCM Agreement* would be met when the subsidy is granted so as to provide an incentive to the recipient to export in a way that is not simply reflective of the conditions of supply and demand in the domestic and export markets undistorted by the granting of the subsidy.[113]

In line with other tests established by the Appellate Body which are supposed to avoid the appearance of examining intent, the Appellate Body establishes objective criteria[114] that are, nevertheless, not free from highly subjective connotations:

> The existence of *de facto* contingency . . . "must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy", which may include the following factors: i) the design and structure of the measure granting the subsidy; (ii) the modalities of operation set out in such a measure; and (iii) the

legal instrument constituting the measure. . . . [F]or a subsidy to be *de jure* export contingent, the underlying legal instrument does not always have to provide *expressis verbis* that the subsidy is available only upon fulfilment of the condition of export performance. Such conditionality can also be derived by necessary implication from the words actually used in the measure.'

[109] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1030 *et seq.* cf. Michael Hahn and Kirtikumar Mehta, 'It's a Bird, It's a Plane: Some Remarks on the Airbus Appellate Body Report *(EC and certain member States—Large Civil Aircraft, WT/DS316/AB/R)*' (2013) *World Trade Review* 12, 139–61; James Flett, 'From Political Pre-Occupation to Legitimate Rule against Market-partitioning: Export Subsidies in WTO Law after the Appellate Body Ruling in the *Airbus* Case' (2012) *Global Trade and Customs Journal* 7, 50–8.

[110] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1063.

[111] Ibid. para. 1064. [112] Ibid. para. 1044. [113] Ibid. para. 1045.

[114] Ibid. para. 1050: 'The standard for *de facto* export contingency is therefore not satisfied by the subjective motivation of the granting government to promote the future export performance of the recipient.'

> relevant factual circumstances surrounding the granting of the subsidy that provide the context for understanding the measure's design, structure, and modalities of operation.[115]
>
> ... [This] is an objective standard ... Indeed, the conditional relationship between the granting of the subsidy and export performance must be objectively observable on the basis of such evidence in order for the subsidy to be geared to induce the promotion of future export performance by the recipient.... [116]

Does that test establish a standard which deviates from de jure export subsidies? And if so, to what extent? After all, it may be imaginable that an explicit linkage between export performance and the granting of a subsidy would *not* qualify as an 'incentive to the recipient to export in a way that is not simply reflective of the conditions of supply and demand in the domestic and export markets undistorted by the granting of the subsidy', for example because the incentive is obviously ineffective. But it would nevertheless be a de jure export subsidy, creating by law a linkage between export performance and subsidy. So could an explicit reference in (domestic) law suffice to render a previously legal subsidy (as it had not met the Appellate Body's high standard for a de facto export subsidy)—subject only to the limitation not to create the consequences described in SCM Article 5—into a prohibited subsidy?[117] In other words: Is there a difference between the standard applicable to de jure export subsidies and those applicable to de facto export subsidies?

It seems difficult to imagine an explicit conditionality between the granting of public funds and export performance that would *not* constitute an incentive to export more, both in absolute and relative terms, than would have been the case under exposure to normal market influences. Because the difference between the WTO regimes for a priori illegal export subsidies and for normal state aids are so stark (in both theory and procedural practice), *some* nexus between subsidy and export performance does not suffice to declare measures of a sovereign member a priori illegal. In the case of the de jure export subsidy, the support measure is explicitly and manifestly contingent on export performance.[118] Clearly, the interpretation of the wording of a text allegedly establishing de jure contingency may prove difficult, and in that case the interpreter will take guidance from the *Airbus* report.

To sum up this point: In line with the general rules, it falls upon the complainant to show (and to the adjudicatory bodies of the WTO to establish) that the state measure in question skews market conditions in order to classify support measures as per se illegal export subsidy. If it cannot be shown that a subsidy is geared to induce more exports, *contrary to market conditions*(!), then it qualifies as a regular actionable subsidy, countervailable pursuant to the SCM Agreement, but not as the one that merits summary justice and a priori condemnation.

[115] Ibid. para. 1046, footnote omitted. [116] Ibid. para. 1050.

[117] See the analysis by Konstantinos Adamantopoulos and Vassilis Akritidis, 'Article 3 SCMA' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Michael Köbele, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade Remedies*, Vol. 4 (Leiden: Martinus Nijhoff Publishers, 2008) 473 *et seq.*

[118] '*De jure* export contingency is demonstrated on the basis of the words of the relevant legislation, regulation or legal instrument. Proving *de facto* export contingency is a much more difficult task': *Canada—Aircraft* (Appellate Body), para. 169 *et seq.*

It is in that light that the test, of whether or not a subsidy has been geared to induce the promotion of future export performance by the recipient, has to be administered. First, hindsight must not come into play: The test 'must be assessed on the basis of the information available to the granting authority at the time the subsidy is granted.'[119] The Appellate Body establishes high thresholds:

> [W]here relevant evidence exists, the assessment could be based on a comparison between, on the one hand, the ratio of *anticipated* export and domestic sales of the subsidized product that would come about in consequence of the granting of the subsidy, and, on the other hand, the situation in the absence of the subsidy. The situation in the absence of the subsidy may be understood on the basis of historical sales of the same product by the recipient in the domestic and export markets before the subsidy was granted. In the event that there are no historical data untainted by the subsidy, or the subsidized product is a new product for which no historical data exists, the comparison could be made with the performance that a profit-maximizing firm would hypothetically be expected to achieve in the export and domestic markets in the absence of the subsidy. Where the evidence shows, all other things being equal, that the granting of the subsidy provides an incentive to skew anticipated sales towards exports, in comparison with the historical performance of the recipient or the hypothetical performance of a profit-maximizing firm in the absence of the subsidy, this would be an indication that the granting of the subsidy is in fact tied to anticipated exportation within the meaning of Article 3.1(a) and footnote 4 of the *SCM Agreement*.[120] (Italics in the original.)

The Appellate Body's report in *EC and certain member States—Large Civil Aircraft* is certainly a welcome concretization of previously developed concepts. Building on previous jurisprudence, it explains clearly (and for the first time) that the decisive criterion for de facto export subsidies is the favouring of exports contrary to market conditions 'over products destined for domestic consumption'.[121] Only such a restrictive interpretation avoids the absurdity that, for instance, most Singaporean subsidies would a priori fall into the category of prohibited subsidies, as subsidies in a small country with an export-oriented economy will more often than not be granted in expectation of export performance and in order to increase such performance.

It seems that the Appellate Body, in order to avoid committing itself too firmly on questions that were either not asked or which could await resolution until a later date, refrained from establishing operational standards. Therefore, the Appellate Body limited itself to establishing some outer parameters of a new export subsidy definition, and illustrated it with an example that shows both, the practicability (in the case at hand) and the remaining, possibly intended, imprecision.

> The following numerical examples illustrate when the granting of a subsidy may, or may not, be geared to induce promotion of future export performance by a recipient. Assume that a subsidy is designed to allow a recipient to increase its future production by five units. Assume further that the existing ratio of the recipient's export sales to domestic sales, at the time the subsidy is granted, is 2:3. The granting of the subsidy

[119] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1049.
[120] Ibid. para. 1047. [121] Ibid. para. 1053.

> will *not* be tied to anticipated exportation if, all other things being equal, the anticipated ratio of export sales to domestic sales is not greater than the existing ratio. In other words, if, under the measure granting the subsidy, the recipient would not be expected to export more than two of the additional five units to be produced, then this is indicative of the absence of a tie. By contrast, the granting of the subsidy would be tied to anticipated exportation if, all other things equal, the recipient is expected to export at least three of the five additional units to be produced. In other words, the subsidy is designed in such a way that it is expected to skew the recipient's future sales in favour of export sales, even though the recipient may also be expected to increase its domestic sales.[122] (Italics in the original.)

Export subsidies are per se illegal, because they represent, in the mercantilist worldview underlying the GATT 1947 and the WTO agreements, an attack on another state. Such a scenario, without doubt, would be caught by the standard offered by the Appellate Body. The new test, however, deals with more complex and realistic constellations: imagine a scenario where the home market is saturated, (yet) inexistent, or a scenario where the market is really a world market. If, under those conditions, a producer wants to expand, the expansion will unavoidably take place not in the domestic market. While the numerical example suggested by the Appellate Body would, at first glance, be cold comfort for such enterprises and the states subsidizing them, the test still reduces drastically the coverage of prohibited subsidies pursuant to SCM Article 3. This is so because the determinative criterion is, according to the Appellate Body, whether the subsidy would change the regular export–import ratio that would have developed under conditions of normal supply and demand.

It appears that many instances of state support would be too complex to be adequately addressed by the complete prohibition of SCM Article 3. In the *Airbus* scenario that was arguably the case: *Airbus* was also an effort to be less dependent on a foreign quasi-monopoly, closely related to the military–industrial complex of a foreign state,[123] an effort to create incentives for further technological leadership, and to preserve and create professional employment opportunities on a large scale. In those circumstances, the regular subsidies regime seems to offer a more appropriate instrument than SCM Part II. Arguably, these circumstances often reflect market situations that cannot be assimilated to the *ceteris paribus* clause 'all other things being equal' (referred to in *EC and certain member States—Large Civil Aircraft* (Appellate Body), paragraph 1047). The performance of a profit-maximizing entrant into a global market dominated by an incumbent with significant market power is likely to be dependent on complex strategic interactions particularly in regard to product launches (such as the famous 'Dreamliner'-category of long-distance planes) which might not have seen the light of day without the new competitive environment. Such market situations can be expected to pose problems for the test proposed since they demand rigorous definitions of the geographic and product markets at issue so as to provide a reliable interpretation of the trends in domestic and export sales.

[122] Ibid. para. 1048.

[123] Public Papers of the Presidents, Dwight D. Eisenhower, 1960, 1035–40, quoted at <http://www.h-net.org/~hst306/documents/indust.html>.

3.2 Import substitution subsidies

Article 3.1(b) reads as follows:

> Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited: . . . (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

In *Canada—Autos*, the Appellate Body stated that contingency 'in law' is demonstrated like export subsidies pursuant to Article 3.1(a) 'on the basis of the words of the relevant legislation, regulation or other legal instrument'.[124] Notwithstanding the fact that the drafters omitted the two-tiered qualification of the necessary contingency 'in law' and 'in fact', the Appellate Body overruled the Panel and held that import substitution subsidies also could be contingent on, either legal determination to use only local content, or factually be made to serve the same purpose. The Appellate Body came to this interpretation, which seems surprising when considering the importance it normally attributes to the wording of norms, based on an *effet utile* interpretation:

> [W]e believe that a finding that Article 3.1(b) extends only to contingency "in law" upon the use of domestic over imported goods would be contrary to the object and purpose of the SCM Agreement because it would make circumvention of obligations by Members too easy.[125]

4. Actionable Subsidies ('Yellow Light Subsidies')

Pursuant to SCM Article 5,

> No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:
> (a) injury to the domestic industry of another Member;
> (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994;
> (c) serious prejudice to the interests of another Member [footnotes omitted].

Thus, the SCM, far from prohibiting subsidies other than those discussed in section 3, only prohibits, again in the polite terminology of the WTO ('no member should . . . '), the causing of harm to other members through the use of state measures which are, as such, perfectly legitimate (see section 1). That it is, nevertheless, a prohibition, and not just an appeal to good behaviour, is evident from the consequences of inflicting 'adverse effects to the interests of other Members'.[126]

[124] *Canada—Autos* (Appellate Body), para. 123, citing *Canada—Aircraft* (Appellate Body), para. 167.
[125] *Canada—Autos* (Appellate Body), paras. 139–43, in particular para. 142.
[126] *EC and certain member States—Large Civil Aircraft* (Panel), paras. 7.44, 7.725–7.728, and 7.1416–7.1417; *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 657 *et seq.*

4.1 Actionable due to 'injury to the domestic industry of another Member'

The first category of actionable subsidies is the one that causes 'injury to the domestic industry of another Member'. Pursuant to SCM Article 5(a), footnote 11 'injury to the domestic industry' is used in the same sense as in Part, which regulates the conditions for imposing countervailing duties. There, footnote 45 to SCM Article 15 determines that the 'injury' may manifest itself in three different ways:

(1) material injury to a domestic industry (see 4.1.3.1),
(2) threat of material injury to a domestic industry (see 4.1.3.2), and
(3) material retardation of the establishment of such an industry (see 4.1.3.3).

Pursuant to SCM Article 15, a determination of one of the above three forms of injury by a member's Investigating Authority (IA) will need to be 'based on positive evidence' and examine (a) the volume of the subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products and (b) the consequent impact of these imports on the domestic producers of such products.

Thus, in order to move to claim that a member has used an actionable subsidy pursuant to SCM Article 5(a), the domestic industry engaging in direct competition with the subsidized producers of 'like products' must suffer injury, which needs to be attributable to the subsidization. We shall examine the elements of this rule in turn.

4.1.1 Like products

SCM Article 15, footnote 46, defines like product as

> a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.[127]

The reader will notice the similarities with the 'like product' definitions discussed earlier in Chapters 6 and 7 on MFN and NT respectively. It comes as no surprise then, that Panels too, starting with *Indonesia—Autos*, have established a parallelism as to the like product analysis between GATT Articles I:1, III:2, and III:4, and the 'likeness' required for an actionable subsidy pursuant to SCM Article 5(a).[128] However, given that the tests discussed above try to reveal whether there is a competitive relationship to be distorted, it should be noted that footnote 46 uses the term 'identity'. As a result of this parallelism, one would have expected a rather narrow definition of the term 'like product'. However, the Panel in *Indonesia—Autos*, focusing rather on the second part of the definition of 'like product' in the SCM ('characteristics closely

For detailed discussions about the privatization and private-to-private sales (effect on pass-through of subsidies) ibid. paras. 726, 733–59; *US—Large Civil Aircraft* (2nd complaint) (Panel), paras. 7.857–7.890.

[127] SCM Art. 15, fn. 46.

[128] *Indonesia—Autos* (Panel), paras. 14.170–14.193; in particular 14.174.

resembling those of the product under consideration') and the function of the SCM to suppress the distortion of trade through subsidies, came to the conclusion that the GATT's case law on 'like product' should guide the likeness analysis.[129]

4.1.2 Domestic industry

The question of domestic industry is highly complex as a practical matter. At a conceptual level, though, the definition is rather straightforward:

> For the purposes of this Agreement, the term "domestic industry" shall, except as provided in paragraph 2, be interpreted as referring to the domestic producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products.[130]

However, the SCM excludes producers related to the exporters or importers and importers of the allegedly subsidized product from the calculation. Given that in many industries *producers* engage in *trading* in order to satisfy the demand of their customers, this can become very relevant.

4.1.3 Injury

A subsidy is not compatible with the regime established by the SCM, if it causes injury to the domestic producers of competing like products. Footnote 11 refers to SCM Part V, and in particular to SCM Article 15 for a definition of the term injury (see earlier). SCM Article 15.1 to 15.6 lays down in considerable detail under what conditions perfectly legitimate state aids turn into WTO-incompatible measures. SCM Article 15.1, which applies to all three categories of injury, recalls that any injury requires an augmentation of the volume of the subsidized imports, an effect of the subsidized imports on prices in the domestic market for like products and, as a consequence of this chain of events, an unfavourable impact of these imports on the domestic producers of such products. Note that SCM Article 15 is not the least a procedural provision, laying down not only the substantive criteria for the determination of what constitutes 'injury', but also what a member may or may not do, through the arm of its IA in a countervailing duty investigation.

4.1.3.1 Material injury to a domestic industry

SCM Article 15 addresses two linked, but separate, issues. The injurious effect on the domestic industry is the reason why subsidies are an issue for members. But injury follows from the immediate consequences of the subsidies granted: better prices leading to increased market shares, in other words: 'unfairly' increased competitiveness. Note, once again, the producer-centred focus that leaves the interests of consumers aside.

[129] Note that the Panel went to find that a kit car is a like product to a finished car: *Indonesia—Autos* (Panel), para. 14.110.

[130] SCM Art. 16.1.

SCM Article 15.2, for instance, addresses both the cause and the effect necessary to meet the material injury threshold. The effects mentioned are (1) 'significant price undercutting', as compared with the price of competing domestic products, (2) 'significant price depression', or (3) the significant 'prevention of price increases, which otherwise would have occurred'. The causes mentioned are 'significant increase in subsidized imports', in absolute or relative terms to the domestic production or consumption. Again, the consumer gets no mention. In the words of the Appellate Body: the cause needs to be the 'explanatory force for the occurrence of significant price depression or price suppression'.[131]

SCM Article 15.3 determines how effect and cause have to be analysed, when subsidized imports from more than one country may or may not cause the injury.[132]

Pursuant to SCM Article 15.5, 'it must be demonstrated that the subsidized imports are, through the effects of subsidies, causing injury'.[133] The parameters indicating material injury are listed in SCM Article 15.4. For the convenience of the reader, this list is reprinted in its relevant parts and in a de-constructed way, in order to show first-time students of WTO law how vast the factual catchment area for determining material injury is. It goes without saying that this favours the finding of material injury, and, on the flipside, renders the defence challenging, even more so, due to the fact that the list reprinted in relevant parts below 'is not exhaustive, nor can one or several of these factors necessarily give decisive guidance'. The examination of the impact of the subsidized imports on the domestic industry shall include

(1) the actual and potential decline in output,
(2) the actual and potential decline in sales,
(3) the actual and potential decline in market share,
(4) the actual and potential decline in profits,
(5) the actual and potential decline in productivity,
(6) the actual and potential decline in return on investments,
(7) the actual and potential decline in or the utilization of capacity,
(8) the factors affecting domestic prices,
(9) the actual and potential negative effects on cash flow,
(10) the actual and potential negative effects on inventories,
(11) the actual and potential negative effects on employment,
(12) the actual and potential negative effects on wages,
(13) the actual and potential negative effects on growth, and, lastly,
(14) the actual and potential negative effects on the ability to raise capital or investments.

Hence, SCM Article 15.4 obliges an IA to determine the impact of subsidized imports on the domestic producers of 'like products' using 'all relevant economic factors and indices

[131] *China—GOES* (Appellate Body), para. 136 *et seq.*
[132] Note that the *de minimis* threshold mentioned is defined in SCM Art. 11.9.
[133] In addition, SCM Art. 15.5 contains pertinent procedural and evidentiary rules and lists factors that could exclude causality.

having a bearing on the state of the industry'. Speaking of SCM Article 15.4 (and its Antidumping Agreement sister provision), the Appellate Body explained:

> We recall that Articles 3.4 and 15.4 thus do not merely require an examination of the state of the domestic industry, but contemplate that an investigating authority must derive an understanding of *the impact* of subject imports on the basis of such an examination. Consequently, Articles 3.4 and 15.4 are concerned with the relationship between subject imports and the state of the domestic industry, and this relationship is analytically akin to the type of link contemplated by the term "the effect of" under Articles 3.2 and 15.2. In other words, Articles 3.4 and 15.4 require an examination of the explanatory force of subject imports for the state of the domestic industry. In our view, such an interpretation does not duplicate the relevant obligations in Articles 3.5 and 15.5. As noted, the inquiry set forth in Articles 3.2 and 15.2, and the examination required under Articles 3.4 and 15.4, are necessary in order to answer the ultimate question in Articles 3.5 and 15.5 as to whether subject imports are causing injury to the domestic industry. The outcomes of these inquiries form the basis for the overall causation analysis contemplated in Articles 3.5 and 15.5. Thus, similar to the consideration under Articles 3.2 and 15.2, the examination under Articles 3.4 and 15.4 *contributes to*, rather than duplicates, the overall determination required under Articles 3.5 and 15.5.[134]

4.1.3.2 Threat of material injury to a domestic industry

Members do not have to wait for their industries to suffer harm before taking defensive measures. Rather, pursuant to SCM Article 15.7, they may move against well-established subsidization pursuant to SCM Articles 1 and 2 when there are 'clearly foreseeable' and 'imminent' changes of circumstances ahead. 'Allegation, conjecture or remote possibility' would not suffice. SCM Article 15.7 lists factors to be considered,[135] when determining whether a 'high degree of likelihood'[136] for the manifestation of said 'clearly foreseeable' and 'imminent' threats exists. They include: (i) the nature of the subsidy or subsidies in question and the trade effects likely to arise therefrom; (ii) a significant rate of increase of subsidized imports into the domestic market indicating the likelihood of substantially increased importation; (iii) sufficient freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased subsidized exports to the importing member's market, taking into account the availability of other export markets to absorb any additional exports; (iv) whether imports are entering at prices that will have a significant depressing or suppressing effect on domestic prices, and would likely increase demand for further imports; and (v) inventories of the product being investigated.

None of these factors is on its own determinative;[137] rather the factors are to be considered in a holistic fashion and 'must lead to the conclusion that further subsidized

[134] *China—GOES* (Appellate Body), para. 149; see also *Thailand—H-Beams* (Panel), para. 7.236; *Korea—Certain Paper* (Panel), para. 7.272, and *EC—Tube or Pipe Fittings* (Appellate Body), para. 131.

[135] cf. *US—Softwood Lumber VI* (Panel), para. 7.97 *et seq*., para. 7.105 in particular with regard to the question whether, after having examined all factors pursuant to SCM Art. 15.4, a second full-blown analysis is required.

[136] *US—Softwood Lumber VI (Article 21.5—Canada)* (Appellate Body), para. 109 *et seq*.

[137] We would argue that here, too, the pertinent antidumping jurisprudence would have to be taken on board. Consequently, all factors listed should be considered as a matter of principle; cf. *Mexico—Corn Syrup* (Panel), para. 7.133.

exports are imminent and that, unless protective action is taken, material injury would occur'. The Appellate Body rejected a more deferential standard to a member's determination when it was facing 'the threat of injury'. Notwithstanding the 'intrinsic uncertainty' of future events,

> a "proper establishment" of facts in a determination of threat of material injury must be based on events that, although they have not yet occurred, must be "clearly foreseen and imminent" . . . [138]

In another report, the Appellate Body added that

> the requirement that the reasoning set out by an investigating authority making a determination of threat of injury must clearly disclose the assumptions and extrapolations that were made, on the basis of the record evidence, regarding future occurrences[;] such assumptions and extrapolations . . . [are to be based] on positive evidence and not merely on allegation, conjecture, or remote possibility; and show a high degree of likelihood that projected occurrences will occur.[139]

It then went on to state:

> Article 15.7(ii) of the SCM Agreement provide[s] that, in making a threat of injury determination, an investigating authority should consider whether there is "a significant rate of increase of [dumped/subsidized] imports into the domestic market indicating the likelihood of substantially increased importation". These provisions lay emphasis on two aspects: first, that there is a "significant" rate of increase in imports; and secondly, that such a rate of increase reveals the likelihood of "substantially" increased importation in the near future. Taken together, they refer to the observed behaviour of the volume of imports.
>
> . . . Article 3.7(i) of the *Antidumping Agreement* and Article 15.7(ii) of the *SCM Agreement* do not prescribe a specific methodology for determining the rate of increase in imports. Whatever be the methodology followed by an investigating authority, its determination must show, on the basis of positive evidence and an objective examination, that the rate of increase of dumped/subsidized imports is "significant" so as to indicate the likelihood of "substantially" increased imports in the near future.[140] (Italics and emphasis in the original.)

4.1.3.3 Material obstruction of the establishment of such an industry

Injury for the purposes of SCM Article 5 may also consist in creating conditions that render the market economically unsustainable. So far, this third alternative has not had any real relevance, as complaints and reports have focused on other aspects of injury.

4.1.3.4 Causation

Pursuant to SCM Article 5, no member should cause, through the use of subsidization, injury to the domestic industry of another member. Injury is defined in SCM Article 15, where paragraph 5 determines that a causal relationship between the subsidized

[138] *Mexico—Corn Syrup (Article 21.5—US)* (Appellate Body), para. 85.
[139] *US—Softwood Lumber VI* (Appellate Body), para. 109. [140] Ibid. paras. 146 and 147.

imports and the injury to the domestic industry is required.[141] What this means has already been discussed earlier in the chapter. Thus, the causality chain that a Panel has to examine encompasses four elements: (1) A subsidization pursuant to SCM Articles 1 and 2, which (2) causes a significant increase of imports (SCM Article 15.2), which causes (cf. the whole of SCM Article 15, including the exclusion of competing causalities) (3) effects on prices (SCM Article 15.2); which cause (4) injury to the domestic industry (SCM Article 15.4).

In *Japan—DRAMs (Korea)*, the Appellate Body elaborated its authoritative reading of the provision:

> Article 15.5 as a whole deals with the causal relationship between subsidized imports and injury to the domestic industry. The first sentence of Article 15.5 requires that an investigating authority demonstrate that "the subsidized imports are, through the effects of subsidies, causing injury" to the domestic industry. The second sentence emphasizes that the demonstration of the causal relationship between the subsidized imports and the injury shall be based on all relevant evidence before the investigating authority. In both sentences, the subject to which the phrase "are causing injury" applies, or in respect of which "a causal relationship" is to be established, is "the subsidized imports".
>
> By virtue of footnote 47 to Article 15.5, which forms an integral part of the first sentence, the demonstration of the causal relationship envisaged in the first two sentences of Article 15.5 is to be carried out by following the analysis set forth in Articles 15.2 and 15.4 for examining the "effects" of the subsidized imports. According to these paragraphs, such an examination will comprise of: (i) whether there has been a significant increase in subsidized imports; (ii) the effect of the subsidized imports on prices; and (iii) the consequent impact of the subsidized imports on the domestic industry.
>
> It is clear from the architecture of Articles 15.2, 15.4, and 15.5 that, for determining whether the "subsidized imports are, through the effects of subsidies, causing injury" to the domestic industry, what is required is the examination of the effects of the subsidized imports as set forth in Articles 15.2 and 15.4. These paragraphs neither envisage nor require the two distinct types of examinations suggested by Korea, namely, an examination of the effects of the subsidized imports as per Articles 15.2. and 15.4; and, a second examination of the effects of the subsidies as distinguished from the effects of the subsidized imports on a case-by-case basis.[142]

[141] 'It must be demonstrated that the subsidized imports are, through the effects of subsidies, causing injury within the meaning of this Agreement. The demonstration of a causal relationship between the subsidized imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities. The authorities shall also examine any known factors other than the subsidized imports which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the subsidized imports. Factors which may be relevant in this respect include, *inter alia*, the volumes and prices of non-subsidized imports of the product in question, contraction in demand or changes in the patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry.' (footnote omitted.)

[142] *Japan—DRAMs (Korea)* (Appellate Body), paras. 262–4.

The Appellate Body then addressed whether and to what extent the IA had to consider other causal events, so that the undesirable effects would not wrongly be attributed to the subsidy:

> [T]he "non-attribution" provisions contained in the third sentence of Article 15.5 already address adequately the concern that the injurious effects of any known factors *other than subsidized imports* are not attributed to the subsidized imports. This ensures that injuries that may have been caused by other known factors are not attributed to the subsidized imports.[143] (Italics in the original.)

4.2 Actionable due to 'nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994'

Pursuant to SCM Article 5 (footnote 12) 'nullification or impairment is used . . . in the same sense as in the relevant provisions of the GATT 1994'. By and large, 'nullification or impairment' is simply presumed where a violation has been shown under the GATT.[144]

4.3 Actionable due to 'serious prejudice to the interests of another Member'

According to SCM Article 5(c), a WTO member should not, through its subsidies, cause serious prejudice to another WTO member. SCM Article 5 (footnote 13) further determines that 'serious prejudice to the interests of another Member' is used in the same sense as it is used in GATT 1994 Article XVI:1, 'and includes threat of serious prejudice'.[145] However, it does not define the term serious prejudice any further; that is left to the subsequent provision.

SCM Article 6.1 gives a non-binding illustration of what 'serious prejudice' may mean. Despite its authoritative language, it has ceased to have any legal force (like the provision on 'green light subsidies') due to a lack of renewal mandated by SCM Article 31. It nevertheless merits attention *colorandi causa*, as it lists types of subsidization considered per se dangerous.[146]

> Serious prejudice . . . shall be deemed to exist in the case of:
> (a) the total ad valorem subsidization of a product exceeding 5 per cent;[147]
> (b) subsidies to cover operating losses sustained by an industry;
> (c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and

[143] Ibid. para. 267. [144] cf. *US—Offset Act (Byrd Amendment)* (Panel), para. 7.120 *et seq*.

[145] cf. the discussion above concerning the threat of material injury, which according to *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1179, informs the pertinent interpretation of SCM Art. 6.3; see also *US—Upland Cotton (Article 21.5.—Brazil)* (Appellate Body), para. 244.

[146] *Korea—Commercial Vessels* (Panel), para. 7.583.

[147] '[Footnote 15 in the original]: Since it is anticipated that civil aircraft will be subject to specific multilateral rules, the threshold in this subparagraph does not apply to civil aircraft.'

which are given merely to provide time for the development of long-term solutions and to avoid acute social problems;

(d) direct forgiveness of debt, i.e. forgiveness of government-held debt, and grants to cover debt repayment.[148]

As helpful as this provision may be for exemplifying prototypical causes for 'serious prejudice', the determinant legal basis for determining 'serious prejudice' is now SCM Article 6.3, which focuses exclusively on the effect of subsidization and not on its a priori nature:[149]

Serious prejudice . . . may arise in any case where one or several of the following apply:

(a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;

(b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market;[150]

(c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;

(d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted [footnotes omitted].

Finally, SCM Article 6.7 lays down six grounds which exclude the existence of serious prejudice.

4.3.1 Definition of market

As the first reading of SCM Article 6.3 reveals, the definition of what is 'serious prejudice to the interests of another member' depends very much on the pertinent market. This issue was debated for the first time in great detail when the question arose whether there was a world market for *Upland cotton*. The Panel understood the notion of market to mean

[148] '[Footnote 16 in the original]: Members recognize that where royalty-based financing for a civil aircraft programme is not being fully repaid due to the level of actual sales falling below the level of forecast sales, this does not in itself constitute serious prejudice for the purposes of this subparagraph.'

[149] This follows from the wording and the structure, as well as the function of SCM Arts. 5 and 6; cf. *US—Upland Cotton* (Panel), para. 7.1392 and *US—Upland Cotton (Article 21.5—Brazil)* (Panel), para. 10.18 *et seq*. In *Korea—Commercial Vessels*, the Panel took the view that although trade damage could serve as a proxy to define *serious prejudice*, the latter should not be equated to the concept of *serious injury*; ibid. para. 7.578 et seq.

[150] Subparagraph 3(b) (change in relative shares of the market to the disadvantage of the non-subsidized like product) and (c) (comparison of prices between subsidized and non-subsidized goods at the same level of trade to quantify the size of price undercutting) receive authoritative interpretation by SCM Art. 6.4 and Art. 6.5, respectively.

> "a place . . . with a demand for a commodity or service"; "a geographical area of demand for commodities or services"; "the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices".
>
> . . . This ordinary meaning does not, of itself, impose any limitation on the "geographical area" that makes up any given market. Nor does it indicate that a "world market" cannot exist for a given product. As the Panel indicated, the "degree to which a market is limited by geography will depend on the product itself and its ability to be traded across distances".
>
> The only express qualification on the type of "market" referred to in Article 6.3(c) is that it must be "the same" market. . . . This contrasts with the other paragraphs of Article 6.3: paragraph (a) restricts the relevant market to "the market of the subsidizing Member"; paragraph (b) restricts the relevant market to "a third country market"; and paragraph (d) refers specifically to the "world market share". . . . [T]his difference may indicate that the drafters did not intend to confine, *a priori*, the market examined under Article 6.3(c) to any particular area.[151]

The Appellate Body then went on to state:

> [T]wo products may be "in the same market" even if they are not necessarily sold at the same time and in the same place or country. As the Panel correctly pointed out, the scope of the "market", for determining the area of competition between two products, may depend on several factors such as the nature of the product, the homogeneity of the conditions of competition, and transport costs. This market for a particular product could well be a "world market". However, . . . the fact that a world market exists for one product does not necessarily mean that such a market exists for every product.[152]

A similar question came up later in the *Airbus–Boeing* dispute. In *EC and certain member States—Large Civil Aircraft*, the Appellate Body discussed whether a price effect was taking place in a particular market. The following discussion is therefore relevant both for the purposes of market definition and of product displacement:

> We construe the concept of displacement as relating to, and arising out of, competitive engagement between products in a market. Aggressive pricing of certain products may, for example, lead to displacement of exports or imports in a particular market. This, however, can only be the case if those products compete in the same market. An examination of the competitive relationship between products is therefore required so as to determine whether such products form part of the same market. We conclude therefore that a "market", within the meaning of Articles 6.3(a) and 6.3(b) of the *SCM Agreement*, is a set of products in a particular geographical area that are in actual or potential competition with each other. An assessment of the competitive relationship between products in the market is required in order to determine whether and to what extent one product may displace another. Thus, while a complaining Member may identify a subsidized product and the like product by reference to footnote 46, the products thereby identified must be analyzed under the discipline of the product

[151] *US—Upland Cotton* (Appellate Body), paras. 404–6. [152] Ibid. para. 408.

> market so as to be able to determine whether displacement is occurring. Ordinarily, the subsidized product and the like product will form part of a larger product market. But it may be the case that a complainant chooses to define the subsidized and like products so broadly that it is necessary to analyze these products in different product markets. This will be necessary so as to analyze further the real competitive interactions that are taking place, and thereby determine whether displacement is occurring.[153]

The Appellate Body rejected the position of the Panel that in a case involving SCM Article 6.3(a) and (b) it is bound by the complainant's definition of the market at stake and chided the Panel for its 'failure to comply with its duties under DSU Article 11' which flowed 'directly from its erroneous interpretation of the requirements of Articles 6.3(a) and 6.3(b) of the SCM Agreement':[154]

> Clearly, there is no inhibition on how a complainant may choose to formulate its claim as to the scope of the "subsidized product";... This does not mean, however, that a panel has no duty to review the complainant's formulation of the scope of the "subsidized product". Rather, the panel has a duty to ascertain the relevant product market or markets in which the complainant's and respondent's products compete. The notion of "subsidized product" and "like product" is, in each case, to be analysed as an integral part of a panel's duty objectively to assess a particular claim of serious prejudice and its obligation to assess the relevant market under Articles 6.3(a) and 6.3(b).[155]

This clarification is to be applauded. It is, clearly, the duty of the Panel to define, whether in reality, pain was inflicted on other members by subsidies. That requires real competitive relationships and not just a claim to that effect by a party to the dispute. The duty of the Panel to examine what the complaining party presents as the factual basis for its claims seems a self-evident proposition: pursuant to DSU Article 11, its task is to make an 'objective assessment' of both facts and law. That seems hardly possible with a boilerplate internalization of the position of one of the parties to the dispute. The importance of defining correctly the relevant product market is to enable a robust evaluation of displacement of a product by a product that exercises on it a competitive constraint. As noted by the Appellate Body 'an assessment of the competitive relationship between products in the market is required in order to determine whether and to what extent one product may displace another.'[156]

Of course, what is surprising at first glance is the geographic compartmentalization of markets (for example, Taiwan, Australia, and India); from an economic perspective, the relevant market for certain products—such as large civil aircrafts (LCAs), but also corn, coffee, certain raw materials—is the global market; for instance, there is no Taiwanese market for LCAs, whereas there may be very important Taiwanese customers. The key to the Appellate Body's approach is the wording of SCM Article 6.3. Its subparagraphs (a) and (b) both concern effects of state aid in a geographically well-defined market: on the one hand 'the market of the subsidizing Member' and, on the

[153] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1119.
[154] Ibid. para. 1128. [155] Ibid. para. 1131. [156] Ibid. para. 1119.

other hand, 'a third country market'. The Appellate Body, as any institution charged with applying the law, has to recognize the normative starting point, even though it may not represent a categorization subscribed to by current economic thinking.

> A plain reading of Articles 6.3(a) and 6.3(b) therefore reveals that an analysis of displacement or impedance under those provisions is limited to the territory of the "subsidizing Member" or the territory of any third country at issue. The manner in which the geographic dimension of a market is determined will depend on a number of factors: in some cases, the geographic market may extend to cover the entire country concerned; in others, an analysis of the conditions of competition for sales of the product in question may provide an appropriate foundation for a finding that a geographic market exists within that area, for example, a region. There may also be cases where the geographic dimension of a particular market exceeds national boundaries or could be the world market, even though Articles 6.3(a) and 6.3(b) would focus the analysis of displacement and impedance on the territory of the subsidizing Member or third countries involved.[157]

The Appellate Body, however, mentions, almost in passing, in footnote 2462 that 'in terms of the geographic dimension of markets under Article 6.3(c) of the *SCM Agreement*, it may be appropriate to examine the "world market" and the conditions of competition as they exist in that market.' This, however, is the only occasion on which to do so, as the first two subparagraphs determine a territorial approach.

4.3.2 Displacement of and impediment to the imports of a like product

Pursuant to SCM Article 6.3(a) and (b), serious prejudice for the purposes of Article 5(c) arises when the effect of the subsidy is 'to displace or impede the imports of a like product of another Member' either with regard to the importation into the market of the subsidizing member[158] or with regard to the importation into a third country market. In the former situation, the subsidizer has protected the home turf of its subsidized entities: for instance (and, of course, purely hypothetically), because Indian cars are subsidized, small foreign cars will no longer be attractive to Indian consumers. In the latter situation, the subsidies have rendered the 'conquest' of third country markets more difficult; for instance (and, again, of course, purely hypothetically), because the United States subsidizes cotton, market access for West African cotton to the markets of Guatemala, Peru, Portugal, Turkey, and Vietnam has become all but impossible.

In *EC and certain member States—Large Civil Aircraft*, the Appellate Body had occasion to authoritatively interpret what 'to displace or impede the imports' means in the context of SCM Article 6.3(a) and (b); we refer to some of the discussion concerning 'market definition'. While there 'could be situations where displacement and impedance overlap',[159] the Appellate Body, as ever attached to the principle of effective treaty interpretation, undertakes to define the terms.

[157] Ibid. para. 1117. [158] cf. *Indonesia—Autos (Panel)*, in particular para. 14.223 *et seq*.
[159] *EC and certain member States—Large Civil Aircraft* (Appellate Body), fn. 2548.

> [D]isplacement is a situation where imports or exports of a like product are replaced by the sales of the subsidized product. . . . We construe the concept of displacement as relating to, and arising out of, competitive engagement between products in a market.[160]

The term 'impede' covers, in the Appellate Body's view, 'a broader array of situations than the term "displace"' and

> [i]t refers to situations where the exports or imports of the like product of the complaining Member would have expanded had they not been "obstructed" or "hindered" by the subsidized product. It could also refer to a situation where the exports or imports of the like product of the complaining Member did not materialize at all because production was held back by the subsidized product.[161]

4.3.3 Serious prejudice due to 'significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market'

In *US—Large Civil Aircraft* (2nd complaint), the Appellate Body confirmed its prior jurisprudence[162] on price suppression and price depression.

> "*[P]rice suppression*" refers to the situation where "prices" . . . either are prevented or inhibited from rising (i.e. they do not increase when they otherwise would have) or they do actually increase, but the increase is less than it otherwise would have been. *Price depression* refers to the situation where "prices" are pressed down, or reduced.[163] (original emphasis)

In *Upland Cotton*, the Appellate Body had highlighted the conceptual differences between 'price suppression' and 'price depression':

> While price depression is a directly observable phenomenon, price suppression is not so. Falling prices can be observed; by contrast, price suppression concerns whether prices are less than they would otherwise have been in consequence of various factors, in this case, the subsidies.[164]

Regardless of these conceptual differences, both 'price suppression' and 'price depression' can only be identified by comparison with a counterfactual that would have to be established by economic theory:

> The identification of price suppression, therefore, presupposes a comparison of an observable factual situation (prices) with a counterfactual situation (what prices would have been) where one has to determine whether, in the absence of the subsidies (or

[160] Ibid. para. 1119; see also *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 1076.
[161] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1161.
[162] *US—Upland Cotton* (Appellate Body), para. 423, quoting *US—Upland Cotton* (Panel), para. 7.1277.
[163] *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 1091.
[164] *US—Upland Cotton (Article 21.5—Brazil)* (Appellate Body), para. 351; in para. 350 where the Appellate Body clarifies that price suppression and price depression may overlap.

> some other controlling phenomenon), prices would have increased or would have increased more than they actually did. . . . The determination of whether such falling prices are the effect of the subsidies will require consideration of what prices would have been absent the subsidies. Thus, counterfactual analysis is an inescapable part of analyzing the effect of a subsidy under Article 6.3(c) of the *SCM Agreement*.[165]

In order to show that indeed serious prejudice exists, the complainant has to show a causal link between a subsidy and undesirable effects. In *Upland Cotton*, the Appellate Body explained:

> We note that Article 6.3(c) does not use the word "cause" but, rather, provides that serious prejudice may arise where "the effect of the subsidy is . . . significant price suppression". . . . We agree that Article 6.3(c) requires the establishment of a causal link, but we observe that, while the term "cause" focuses on the factors that may trigger a certain event, the term "effect of" focuses on the results of that event. The effect—price suppression—must result from a chain of causation that is linked to the impugned subsidy.[166]

The term 'lost sales' was defined by the Appellate Body as a sale that a supplier 'failed to obtain'.[167]

> We further understand lost sales to be a relational concept that includes consideration of the behaviour of both the subsidized firm(s), which must have won the sales, and the competing firm(s), which allegedly lost the sales. In *US—Upland Cotton*, the Appellate Body held that the phrase "in the same market" applied to all four situations set forth in Article 6.3(c), including "lost sales".[168] According to the Appellate Body, the subsidized product and the like product of the complaining Member will be in the same market "if they were engaged in actual or potential competition in that market."[169] Thus, sales can be lost "in the same market" within the meaning of Article 6.3(c) if the subsidized product and the like product are competing products in the same product market.[170]

'Significant price undercutting', 'significant price suppression', 'significant price depression', or 'significant lost sales' are concepts that may overlap. Nevertheless Panels ought to try to distinguish those concepts and attempt suitable examinations. However, all three concepts have one characteristic in common: their 'significance'. Thus, the negative effect needs to be more than a dent in the commercial expectations of the producers of like products. Rather, all these negative effects have to be 'important' and 'consequential'.[171] In determining whether that is the case, Panels have to take

[165] Ibid. para. 351. [166] Ibid. para. 372.
[167] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1214.
[168] '[Footnote in the original]: *US—Upland Cotton* (Appellate Body), para. 407'.
[169] '[Footnote in the original]: *US—Upland Cotton* (Appellate Body), para. 408'.
[170] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1214.
[171] *US—Upland Cotton* (Appellate Body), para. 426, confirming *US—Upland Cotton* (Panel), para. 7.1326.

a holistic approach,[172] taking into account quantitative and qualitative dimensions[173] and pay attention to the particularities of the subsidization,[174] of the products and of the markets[175] and the effects in them.[176]

4.3.4 Serious prejudice due to 'an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity'

Pursuant to SCM Article 6.3(d), there is serious prejudice if the effect of the subsidy is an increase in the world market share of a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.[177]

4.4 Methodology and causality issues

In the 'real world'[178] winning or losing a subsidies case usually depends on two issues, both of which are related to the substantive legal issues, but with differences. The first issue concerns methods that may be used in establishing the harmful consequences of subsidization. In this context the following questions arise: What is the role played by economic experts? May the Panel or the state use facts (readily) available or is a major inquiry necessary? If 'facts available' are allowed to be used in a case when a party having the easiest access to more specific facts does not produce them, is it then, as a form of (negative) sanction, permissible for the adjudicative body (or for a member's Investigative Authority (IA))[179] to use 'total facts available' and disregard more specific (and possibly advantageous) factual information? Do benefits emanating from the grating of subsidies ever end? If so, when? When several authorities, in a joined manner or independently of each other engage in financial contributions, must they (or may they) be consolidated for subsidy analysis?

The second issue constantly cropping up are questions of causation: is there a 'substantial and genuine' link between the cause and effect, between, for instance, subsidization and disadvantageous consequences in the market? We shall address both issues in turn; the discussion though will be most sketchy indeed. The above-mentioned issues, inevitably, turn on the very complicated facts of organized subsidization, exemplified by the thousands of pages written so far by the Appellate Body and

[172] *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 1193.

[173] *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 1052; *US—Upland Cotton* (Appellate Body), para. 490, confirming *US—Upland Cotton* (Panel), para. 7.1325, and 7.1329.

[174] *US—Upland Cotton* (Appellate Body), para. 434.

[175] *US—Upland Cotton (Article 21.5—Brazil)* (Appellate Body), para. 416 *et seq.*

[176] *US—Upland Cotton* (Panel), paras. 7.1330–7.1332.

[177] cf. ibid. para. 7.1464 *et seq.*; not decided subsequently by the Appellate Body, para. 505 *et seq.*

[178] This is where 'people live and work and die'—obviously, a very work-centric place—and where, nevertheless, laboratory conditions do not necessarily apply; *EC—Hormones* (Appellate Body), para. 187.

[179] cf. SCM Art. 14.

the Panels in the *Airbus–Boeing* dispute, but also the sophisticated efforts by the United States and the EU to keep their agricultural subsidies in line with their AoA obligations.

4.4.1 Causation issues

Causation and the exclusion of causation are at the centre of some of the discussion reproduced above.[180] Whereas SCM Article 5 does use the word 'cause',[181] SCM Article 6, which defines 'serious prejudice' only mentions certain effects, such as 'displacements', 'impediments', 'significant price undercutting', 'significant price suppression, price depression or lost sales', or 'an increase in the world market share of the subsidizing Member'. However, the word 'effect' describes the consequence of a measure or an activity that causes that consequence: without such a nexus[182] it would not be an 'effect'.

This rather straightforward recognition has been endorsed by the Appellate Body and the Panels. They demand, in line with what is demanded in national private and competition law, a qualified form of causality. In some domestic legal systems the term 'adequate causality' is used (for instance in Germany and Switzerland). In many Anglo-Saxon systems the doctrine of 'proximate causation' is well established to exclude causal links that, while causal, do not have the degree of intensity necessary for the legal consequence to arise (as a standard example: the mother of the wrongdoer is, just because of the fact that she has given birth, not responsible for the deeds of her son under both criminal and private law). 'Mere correlation', thus, does not suffice to establish the requisite causality in a successful SCM complaint.[183]

Accordingly, as a first step, a 'causal link',[184] a 'chain of causation that is linked to the impugned subsidy',[185] has to be established; for this, any type of test will do. However, while this may in practice be sufficient in the vast majority of cases in which the causal link is straightforward and evident, it falls short of what may be required in factually complex cases where causation is a contended issue. This is where the qualification ('the adequacy' of German and 'the proximity' of English law) kicks in: the Appellate Body calls the required qualified causality nexus 'genuine and substantial relationship of cause and effect'.[186] This does not require the exclusivity of the causation, but rather an evaluation of whether the subsidy in effect leads to the consequences that render the subsidy WTO-incompatible.[187] What this means in detail depends on the different

[180] cf. 4.1.3.4.

[181] 'No Member should cause, through the use of any subsidy . . . adverse effects to the interests of other Members, i.e.: (a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits . . . (c) serious prejudice . . . '.

[182] A word used, for example, by the Panel in *US—Upland Cotton* (Panel), para. 7.1192.

[183] *US—Upland Cotton* (Appellate Body), para. 451.

[184] See, for example, *US—Upland Cotton* (Panel), para. 7.1341, confirmed by *US—Upland Cotton* (Appellate Body), para. 435.

[185] *US—Upland Cotton (Article 21.5—Brazil)* (Appellate Body), para. 372.

[186] *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), paras. 913–14 with further references ; see also *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1232; *US—Upland Cotton* (Appellate Body), para. 438 *et seq.*

[187] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1233; *US—Upland Cotton* (Appellate Body), para. 431 *et seq.*

subparagraphs of SCM Article 6.3 and the undesirable consequences listed there as characteristic of 'serious prejudice'. The pertinent case law is too expansive to present in the framework of this introduction; in fact, some pertinent discussions by the Appellate Body have already been discussed in the context of presentation of the substantive norm. In a nutshell, Panels are called upon by the Appellate Body to engage in a holistic exercise that would take all relevant factors into account,[188] including both quantitative and qualitative aspects. Whereas size does not matter per se, 'the magnitude of the [challenged] subsidies'[189] may be used as indicator of non-benign consequences in the pertinent market. This may be done as part of or in parallel with a counterfactual analysis.[190] It is in this context that the trier of facts[191] has to exclude that other reason than the challenged subsidy is the cause of the un-neighbourly infringement of another member's interests.[192]

4.4.2 Methodology issues

As indicated above, the Appellate Body has expressed a general preference for holistic approaches. In *US—Upland Cotton*, the Appellate Body favoured an analysis of the four scenarios of undesirable effects of subsidies pursuant to Article 6.3 according to one, all-encompassing examination.[193] This was on the occasion of being confronted with the Panel's three-step examination of SCM Article 6.3(c), which had first examined whether significant price suppression existed, before then moving to examine whether this was the effect ('causation') of the subsidy in question. It would seem that a significant part of that discussion is more shaped by semantic than by substantive differences: Members and the WTO's adjudicative organs have to abide by the rules laid down by the WTO members. Hence, any Panel has to examine all elements of the norm in question, and of course even a staggered approach does not mean that the individual elements are insulated from each other.

More than in other areas of WTO law, the Appellate Body has recognized the added value economic modelling may bring to a legal analysis of SCM Article 6.3. This has been much noticed and will, undoubtedly, reinforce the already very robust trend to use economists in dispute settlement procedures. In *EC and certain member States—Large Civil Aircraft*, the Appellate Body underlines the importance of an analysis comparing the sales actually made by the competing firm(s) of the complaining

[188] *US—Upland Cotton* (Appellate Body), para. 461 et *seq*.

[189] *US—Upland Cotton (Article 21.5—Brazil)* (Appellate Body), para. 443; see also *US—Upland Cotton* (Appellate Body), para. 461 *et seq*.

[190] *US—Upland Cotton (Article 21.5—Brazil)* (Appellate Body), para. 375.

[191] Note that in the context of determining the WTO-compatibility of a subsidy, the Panel is the first trier of facts; unlike in complaints, where the WTO-compatibility of countervailing measures is at stake, the Panel does not have to reduce its analysis to the examination of whether the IA's determination was tenable; cf., for example, *US—Upland Cotton* (Appellate Body), para. 458.

[192] See, for instance, *US—Upland Cotton (Article 21.5—Brazil)* (Appellate Body), para. 309; *US—Large Civil Aircraft* (2nd complaint) (Appellate Body), para. 914; *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1376; *US—Upland Cotton* (Appellate Body), para. 437.

[193] *US—Upland Cotton* (Appellate Body), para. 431 *et seq*.; more explicitly in favour of a unitary approach, *US—Upland Cotton (Article 21.5—Brazil)* (Appellate Body), para. 361.

member with the sales resulting from a counterfactual scenario in which the firm(s) of respondent member would not have received the challenged subsidies.[194]

5. Counteracting Subsidies: The Multilateral Track

Members have the choice of two different tracks to move against WTO-incompatible subsidies. The first track leads to autonomously determined countervailing duties in addition to other import levies (such as, in particular, tariffs) in order to reduce or completely undo the undesired consequences of subsidized import competition. By choosing the second track, exclusively or in parallel, members affected may use the WTO dispute settlement mechanism to force the member acting in violation of the SCM's subsidies regime to return to WTO-compatible behaviour. Whereas both tracks may be used simultaneously, only one form of relief (either a CVD or an enforcement measure pursuant to Article 4 or 7) shall be available 'with regard to the effects of a particular subsidy in the domestic market of the importing Member'.[195]

5.1 Prohibited subsidies

SCM Article 4 establishes a special procedure to evaluate the claim that another member is using prohibited subsidies. Ultimately, this may lead to the authorization to suspend obligations benefiting the wrongdoer in order to exercise sufficient pressure to motivate the addressee to return to WTO-compatible behaviour.

SCM Article 4 deviates from the ordinary DSU procedure insofar as it establishes much shorter deadlines, and thus allows a particularly swift response. Pursuant to SCM Article 4.7, if a subsidy is found to be prohibited,[196] the subsidizing WTO member will be requested to withdraw the subsidy without delay and not (as it is the norm pursuant to the DSU), within 'a reasonable period of time'.[197] The Panel has to determine the time period that will constitute a withdrawal 'without delay' in a particular case.[198]

[194] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1216; a central element in the counterfactual underlying the Appellate Body's report is that displaced and lost sales for Boeing to certain geographic destinations occurred because the challenged subsidies made it possible for Airbus to launch rival offerings at the time it did. But for the subsidies, there would not have been the availability of competitive alternatives and wider choice of large civil aircraft specifications; as a consequence, no loss or displacement of Boeing sales over the reference period would have taken place.

[195] cf. fn. 35 to SCM Article 10, and pp. 299–304 above.

[196] WTO Panels *may* request a permanent group of experts (PGE), established for this purpose, to pronounce on the prohibited character of a subsidy scheme, SCM Art. 4.5. The PGE was established following a decision by the SCM Committee (WTO Doc. G/SCM/4 of 22 June 1995). As PGE decisions on the nature of a subsidy would be binding upon the Panel, it comes as no surprise that the Panels have shied away from abdicating their role, and have (at the time of writing) not once used this procedure pursuant to SCM Art. 4.5.

[197] Marit E. Janow and Robert W. Staiger, 'Canada—Measures Affecting the Importation of Dairy Products and the Exportation of Milk' in Henrik Horn and Petros C. Mavroidis, eds., *The WTO Case Law of 2001: The American Law Institute Reporters' Studies* (Cambridge University Press, 2003), 236–80.

[198] '[W]hen a panel finds a measure at issue to be a prohibited subsidy, the panel is required to make a recommendation with two components: (i) that the subsidy be withdrawn "without delay"; and (ii) that the time period within which the subsidy must be withdrawn be specified by the Panel. When such a recommendation is adopted by the DSB, it must be, by virtue of Article 17.14 of the DSU, "unconditionally accepted by the parties to the dispute", and it thus becomes effective and binding on the parties. Pursuant to

If, however, the subsidy found to be prohibited is not withdrawn, the injured party may have recourse to appropriate countermeasures.[199] Again, the SCM deviates from the standard deemed appropriate for the remedies against other violations of the WTO Agreement: DSU Article 22.4 uses the term equivalent to describe the relationship between the damage inflicted and the intensity of permissible counteraction to force the wrongdoer to end his behaviour. Clearly, a rougher form of justice seemed acceptable to the drafters of the SCM. They did, however, make clear that completely disproportionate countermeasures would not be acceptable: the expression 'appropriate' was clarified in SCM Article 4.9, footnote 9 as 'not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.'

The practice of WTO adjudicating bodies reflects the fact that prohibited subsidies are the object of some of the strongest language in any WTO agreement with regard to the degree of their WTO-incompatibility.[200] Therefore, it comes as no surprise that SCM Article 4.7 is understood differently from DSU Article 19.1:

> [T]he obligation of the subsidizing Member to withdraw the prohibited subsidy "without delay", and within the time period specified, emanates from a finding of a violation of Article 3 of the *SCM Agreement* and a consequent Article 4.7 recommendation once adopted by the DSB. That recommendation under Article 4.7 remains in effect until the Member concerned has fulfilled its obligation by *fully* withdrawing the prohibited subsidy. Where a Member withdraws a prohibited subsidy only in part, it has failed to comply *fully* with its WTO obligation and the Article 4.7 recommendation continues to be in effect with respect to the part of the subsidy that has not been withdrawn.[201] (Italics and emphasis in the original.)

One Panel has found SCM Article 4.7 to be a proper legal basis for prompt reimbursement of the prohibited subsidy by the subsidized operator to the subsidizing state, going beyond what had been claimed by the complainant in the particular case:

> An interpretation of Article 4.7 of the SCM Agreement which would allow exclusively "prospective" action would make the recommendation to "withdraw the subsidy" under Article 4.7 indistinguishable from the recommendation to "bring the measure into conformity" under Article 19.1 of the DSU, thus rendering Article 4.7 redundant.[202]

Article 4.10 of the SCM Agreement, if compliance with an Article 4.7 recommendation is not achieved within the time period specified, the DSB may authorize the imposition of appropriate countermeasures upon the subsidizing Member'; *US—FSC (Article 21.5—EC II)* (Appellate Body), para. 82.

[199] SCM Art. 4.10.

[200] Whereas, DSU Art. 19 requests Panels, if they are of the opinion that a measure is WTO-incompatible, to *recommend* that the WTO member concerned bring its measures into compliance, without specifying how, SCM Art. 4.7 requests Panels, in cases where they find that a *prohibited* subsidy was granted, to *recommend* that 'the subsidizing Member withdraw the subsidy without delay.'

[201] *US—FSC (Article 21.5—EC II)* (Appellate Body), para. 83; similarly, full *withdrawal* of a prohibited subsidy within the meaning of SCM Art. 4.7 cannot be achieved by a measure replacing the original subsidy with yet another prohibited subsidy, ibid.

[202] *Australia—Automotive Leather II (Article 21.5—US)* (Panel), para. 6.31; see the extensive review by Piet Eeckhout, 'Chapter 15 – Remedies and Compliance' in Daniel Bethlehem, Donald McRae, Rodney

Neither the Appellate Body nor other Panels have distanced themselves from that position. However, in contrast to the *Australia—Automotive Leather II (Article 21.5—US)* Panel, they have limited themselves to deciding the claims presented to them.[203]

In *Brazil—Aircraft (Article 22.6—Brazil)*,[204] the Panel had the opportunity to clarify the ambit of appropriate countermeasures and explain the relationship between SCM Article 4.10 and DSU Article 22.4.[205] This case (and its 'twin' dispute, *Canada—Aircraft*) concerned (export) subsidization by Canada and Brazil of their respective national aircraft producers. The arbitrators first explained the difference in the function of the remedy against a prohibited subsidy, as opposed to remedies to address any other nullification or impairment of WTO members' rights:

> [T]he purpose of Article 4 is to achieve the *withdrawal* of the prohibited subsidy. In this respect, we consider that the requirement to withdraw a prohibited subsidy is of a different nature than removal of the specific nullification or impairment caused to a Member by the measure. The former aims at removing a measure which is presumed under the WTO Agreement to cause negative trade effects, irrespective of who suffers those trade effects and to what extent. The latter aims at eliminating the effects of a measure on the trade of a given Member; the fact that nullification or impairment is established with respect to a measure does not necessarily mean that, in the presence of an obligation to withdraw that measure, the level of appropriate countermeasures should be based only on the level of nullification or impairment suffered by the Member requesting the authorisation to take countermeasures.[206] (Emphasis in the original.)

Thus, the Panel opined that the quantification of appropriate countermeasures should be linked to a benchmark other than the damage suffered by the complainant. That result was, in the Panel's view, not too onerous since it assumed that Brazil gained more from its subsidies than it spent. The Panel also rejected the argument that the benchmark applied amounted to 'punitive damages', for which neither the DSU nor the SCM would provide a sufficient legal basis:

> Indeed, the level of countermeasures simply corresponds to the amount of subsidy which has to be withdrawn. Actually, given that export subsidies usually operate with a multiplying effect (a given amount allows a company to make a number of sales, thus gaining a foothold in a given market with the possibility to expand and gain market shares), we are of the view that a calculation based on the level of nullification or impairment would, as suggested by the calculation of Canada based on the harm caused to its industry, produce higher figures than one based exclusively on the amount of the subsidy. On the other hand, if the actual level of nullification or

Neufeld, and Isabelle van Damme, eds., *The Oxford Handbook of International Trade Law* (Oxford University Press, 2009) 450 *et seq.*

[203] *Brazil—Aircraft (Article 21.5—Canada)* (Panel), fn. 17; *Canada—Aircraft (Article 21.5—Brazil)* (Panel), para. 5.48; but see the Minutes of the DSB meeting of 11 February 2000, WTO doc. WT/DSB/M/75, which record strong opposition by the members. It should be noted, however, that this opposition did not lead to a proposal of rejecting the adoption via 'negative consensus'.

[204] *Brazil—Aircraft (Article 22.6—Brazil)* (Arbitrators).

[205] Ibid. paras. 3.42–3.60.

[206] *Brazil—Aircraft (Article 22.6—Brazil)* (Arbitrators), para. 3.48; see also *Brazil—Aircraft (Article 21.5—Canada)* (Appellate Body), para. 45.

impairment is substantially lower than the subsidy, a countermeasure based on the actual level of nullification or impairment will have less or no inducement effect and the subsidizing country may not withdraw the measure at issue.

. . . A countermeasure [only] becomes punitive when it is not only intended to ensure that the State in breach of its obligations bring its conduct into conformity with its international obligations, but contains an additional dimension meant to sanction the action of that State. Since we do not find a calculation of the appropriate countermeasures based on the amount of the subsidy granted to be disproportionate, we conclude that, a fortiori, it cannot be punitive.[207]

The same logic of linking the amount of countermeasures to the amount of subsidy paid, was followed in the Arbitrators' report on *US—FSC (Article 22.6—US)*.[208] The Arbitrators, extensively referring to the International Law Commission reports on State Responsibility, held that the complainant should be authorized to adopt countermeasures up to an amount similar to the amount of subsidies paid by the United States to the beneficiaries of the FSC scheme.[209] They added a caveat:

In the circumstances of this case, the European Communities is the sole complainant seeking to take countermeasures in relation to this particular violating measure. That is also, in our view, a relevant consideration in our analysis. Had there been multiple complainants each seeking to take countermeasures in an amount equal to the value of the subsidy, this would certainly have been a consideration to take into account in evaluating whether such countermeasures might be considered to be not "appropriate" in the circumstances. That is not, however, the situation before us.[210]

To sum up: WTO adjudicating bodies, when called upon to define the term appropriate countermeasures, took the amount of subsidy paid as reference, rather than the trade effects caused. If this is more than a pragmatic approach, it would indicate that in the case of prohibited subsidies, the act of subsidization itself is nullifying the right of the complaining party, and not just—as is the case with respect to actionable subsidies—the harmful consequences of the subsidization.

5.2 Actionable subsidies

SCM Article 7 is one of the 'special or additional rules and procedures on dispute settlement contained in the covered agreements that are identified in Article 1.2 and Appendix 2 of the DSU, which prevail over the general DSU rules and procedures to

[207] *Brazil—Aircraft (Article 22.6—Brazil)* (Arbitrators), paras. 3.54–3.55.

[208] *US—FSC (Article 22.6—US)* (Arbitrator).

[209] Ibid. paras. 6.1–6.32.

[210] Ibid. para. 6.27. The Arbitrators' claim that that they would have ended up with the same amount, had they used the EC trade effects as benchmark to quantify the *appropriateness* of countermeasures, and this passage seem hard to reconcile. The Arbitrators calculated total trade effects (something which is discernible from the report). Then if the trade effects calculation is correct, this is a case where (total) trade effects yield a number as high as the amount of subsidy paid. However, since the number chosen is a number within a range of possibilities, we simply do not know if the EC injury is within the lower or the higher ebb of the range. In other words, the EC might have been over- or under-compensated depending on the placement of its injury within the range calculated in the Arbitrators' report.

the extent that there is a difference between them.'[211] Pursuant to SCM Article 7.2, a member may request consultations and subsequently initiate a Panel procedure (SCM Article 7.4), provided it can show (a) the existence and nature of the subsidy in question, and (b) the injury caused to the domestic industry, or (c) the nullification or impairment, or (d) serious prejudice, that is, the four reasons for rendering a subsidy actionable, listed in the substantive provisions of SCM Article 5, discussed above in section 4.

The strict time limits applicable might have a negative impact on the information gathering process, which is far from being an easy task in cases involving serious prejudice anyway. This is why Annex V to the SCM provides for procedures aimed at facilitating this process. To this effect, the DSB shall designate a representative, whose task, pursuant to paragraph 4 of Annex V consists in ensuring

> the timely development of the information necessary to facilitate expeditious subsequent multilateral review of the dispute. In particular, the representative may suggest ways to most efficiently solicit necessary information as well as encourage the cooperation of the parties.[212]

SCM Article 7.8 requests from the WTO member causing adverse effects through its subsidies to take the 'appropriate steps to remove the adverse effects' or 'withdraw the subsidy'.

> The use of the terms "shall take" and "shall withdraw" indicate that compliance with Article 7.8 of the SCM Agreement will usually involve some action by the respondent Member. . . . A Member would normally not be able to abstain from taking any action on the assumption that the subsidy will expire or that the adverse effects of the subsidy will dissipate on their own.
>
> The question then becomes: With respect to which subsidies must the implementing Member take such action? Such action would certainly be expected with respect to subsidies granted in the past and which may have formed the basis of a panel's determination of present serious prejudice and adverse effects. However, we do not see the obligation in Article 7.8 as being limited to subsidies granted in the past. Article 7.8 expressly refers to a Member "granting or maintaining such subsidy". The verb "maintain" suggests, to us, that the obligation set forth in Article 7.8 is of a continuous nature, extending beyond subsidies granted in the past. This means that, in the case of recurring annual payments, the obligation in Article 7.8 would extend to payments "maintained" by the respondent Member beyond the time period examined by the panel for purposes of determining the existence of serious prejudice, as long as those payments continue to have adverse effects. Otherwise, the adverse effects of subsequent payments would simply replace the adverse effects that the implementing Member was under an obligation to remove.[213]

[211] *US—Upland Cotton (Article 21.5—Brazil)* (Appellate Body), para. 235.

[212] For the application of this provision see *Indonesia—Autos* (Panel), paras. 1.17–1.19. cf. *Korea—Commercial Vessels* (Panel), paras. 1.11–1.14 and Attachment 1, which was its first comprehensive application. In the latter dispute the working procedures for the designated representative were explained and it was made clear that the designated representative managed to respect the sixty-day period enshrined in Annex V, para. 5.

[213] *US—Upland Cotton (Article 21.5—Brazil)* (Appellate Body), paras. 236–7.

As a last resort, in a case of non-compliance, the injured WTO member can take countermeasures, pursuant to SCM Article 7.9.

> In the event the Member has not taken appropriate steps to remove the adverse effects of the subsidy or withdraw the subsidy within six months from the date when the DSB adopts the panel report or the Appellate Body report, and in the absence of agreement on compensation, the DSB shall grant authorization to the complaining Member to take countermeasures, commensurate with the degree and nature of the adverse effects determined to exist, unless the DSB decides by consensus to reject the request.

In case of disagreement between the parties as to whether the proposed countermeasures respect the letter of SCM Article 7.9, an Arbitrator will define their level.[214]

6. Counteracting Subsidies: Countervailing Duties as a Unilateral Option

6.1 The substantive conditions for lawful imposition, in particular injury

Pursuant to SCM Articles 10 and 32.1 and in conjunction with GATT Article VI, countervailing measures can be imposed against both actionable and prohibited subsidies, provided the following substantive requirements—listed in SCM Article 11.2 with regard to procedural requirements for a valid application 'by or on behalf of the domestic industry' are being satisfied: (1) a (specific) subsidy, (2) subsidized imports of like products, (3) injury within the meaning of GATT 1994 Article VI, as interpreted by SCM Article 15,[215] and (4) a causal link between the subsidized imports and the alleged injury. Most of these questions have already been discussed above; pursuant to SCM Article 15.1,

> [a] determination of injury for purposes of Article VI of GATT 1994 shall be based on positive evidence and involve an objective examination of both (a) the volume of the subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products and (b) the consequent impact of these imports on the domestic producers of such products.

The SCM distinguishes between definitive (imposed at the end of the investigation) and provisional CVDs (imposed before the end of the investigation, on the basis of a preliminary affirmative finding of a subsidy causing injury)[216] and lays down the requirements for the full investigation, preliminary decision, and the review of any decision taken.[217]

[214] SCM Art. 7.10.

[215] Fn. 45 to the SCM Agreement determines that 'injury' shall, unless otherwise specified, mean material injury to a domestic industry, threat of material injury to a domestic industry, or material retardation of the establishment of such an industry.

[216] Pursuant to SCM Art. 17.2, provisional measures can take a form other than CVDs.

[217] cf. SCM Arts. 11, 17, and 19.

6.2 The procedural conditions for lawful imposition

6.2.1 Application by or on behalf of the domestic industry

Pursuant to SCM Article 11.1, a member may only start the procedure upon 'application [. . .] by or on behalf of the domestic industry'.[218] However, in exceptional cases, not further defined in SCM Article 11.6, the state may engage in CVD proceedings *sua sponte*. The reason for this procedural safeguard is the pragmatic assumption that if 'substantially all' the producers of 'like products' are needed to raise such an issue—which inevitably involves time, effort, and cost—the likelihood for unfounded complaints by inefficient individual competitors decreases and the likelihood of bona fide complaints increases. In fairness, however, the standard is more lenient than 'significantly all' domestic producers. Pursuant to SCM Article 11.4,

> [t]he application shall be considered to have been made "by or on behalf of the domestic industry" if it is supported by those domestic producers whose collective output constitutes more than 50 per cent of the total production of the like product produced by that portion of the domestic industry expressing either support for or opposition to the application. However, no investigation shall be initiated when domestic producers expressly supporting the application account for less than 25 per cent of total production of the like product produced by the domestic industry.

In practice, this first condition can be more difficult to fulfil than one would think at first glance. Producers harmed by subsidies of a foreign state, may have interests in the subsidizing states; in fact, they typically have, as the vast majority of world trade is attributable to less than 10,000 firms, which tend to be present in many markets. For good reason, these (big and small) multinationals fear reprisals by the subsidizing state, if they support the application for initiating a procedure. In some states, such perceived disloyalty may entail significantly reduced business opportunities, and even more drastic consequences. For this reasons, operators threatened by revenge action may abstain from supporting, or even oppose—possibly *contre coeur*—an application. Given that an application needs at least the support of companies representing a quarter of all production of like products, the required quorum is a tenable compromise between avoiding specious complaints and allowing real concerns to be addressed.

Once that threshold has been passed, the IA has to examine whether the application satisfies the demands of SCM Article 11.2, pursuant to which an application

> shall include sufficient evidence of the existence of (a) a subsidy and, if possible, its amount, (b) injury . . . , and (c) a causal link between the subsidized imports and the alleged injury. Simple assertion, unsubstantiated by relevant evidence, cannot be considered sufficient to meet the requirements of this paragraph. The application shall contain such information as is reasonably available to the applicant on the following:
>
> (i) the identity of the applicant and a description of the volume and value of the domestic production of the like product by the applicant. . . .

[218] cf. *US—Offset Act (Byrd Amendment)* (Appellate Body), para. 282.

(ii) a complete description of the allegedly subsidized product, the names of the country or countries of origin or export in question, the identity of each known exporter or foreign producer and a list of known persons importing the product in question;

(iii) evidence with regard to the existence, amount and nature of the subsidy in question;

(iv) evidence that alleged injury to a domestic industry is caused by subsidized imports through the effects of the subsidies; this evidence includes information on the evolution of the volume of the allegedly subsidized imports, the effect of these imports on prices of the like product in the domestic market and the consequent impact of the imports on the domestic industry, as demonstrated by relevant factors and indices having a bearing on the state of the domestic industry, such as those listed in paragraphs 2 and 4 of Article 15.

Whereas the above checklist contains positions that would seem easy enough to fulfil, in practice, it requires considerable effort by the IA of the acting member.

6.2.2 Role of the Investigating Authority

Pursuant to SCM Article 11.3, the IA has the duty to 'review the accuracy and adequacy of the evidence provided in the application to determine whether the evidence is sufficient to justify the initiation of an investigation'. To 'review the accuracy and adequacy' and 'to determine whether the evidence is sufficient to justify the initiation of an investigation' implies the duty to be unbiased and objective. While these terms can be found in Anti-Dumping Agreement[219] Article 17.6,[220] the SCM in Article 15.1 explicitly only requires the determination of injury to

> be based on positive evidence and involve an objective examination of both (a) the volume of the subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products[221] and (b) the consequent impact of these imports on the domestic producers of such products.

Still, WTO jurisprudence rightly assumes in the light of the aforementioned provisions and the right of *all interested parties* pursuant to SCM Article 12.1. to receive 'ample opportunity to present in writing all evidence which they consider relevant' that an IA has the duty to be fair, transparent, and even-handed. Furthermore, an IA has to pursue a balancing role between the interest of the domestic industry to be protected from certain undesirable consequences of subsidized imports and the interest of the subsidized producers and their home states to enjoy market access pursuant to WTO

[219] Agreement on Implementation of Article VI of the GATT 1994, usually referred to as the Anti-Dumping Agreement (ADA).

[220] There, the pertinent 'panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective'.

[221] Fn. 46 to the SCM Agreement: 'Throughout this Agreement the term "like product" ("produit similaire") shall be interpreted to mean a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.'

law, free from red tape through unwarranted CVD procedures.[222] However, despite the fact that the decision to formally initiate a CVD investigation has very serious effects on the exporter concerned, the pertinent 'quantity and ... quality of the evidence required to meet the threshold of sufficiency of the evidence' is less demanding than that 'required for a preliminary or final determination.'[223]

> [W]hile the amount and quality of the evidence required at the time of initiation is less than that required to reach a final determination, at the same time the requirement of "sufficient evidence" is also a means by which investigating authorities filter those applications that are frivolous or unfounded. Although definitive proof of the existence and nature of a subsidy, injury and a causal link is not necessary for the purposes of Article 11.3, adequate evidence, tending to prove or indicating the existence of these elements, is required. Indeed, in considering the quality of the evidence that should be provided in an application before an investigation is justified, we note that Article 11.2 requires "sufficient evidence of the *existence* of a subsidy", meaning that the evidence should provide an indication that a subsidy actually exists. It is also clear from the terms of Article 11.2 that "simple assertion, unsubstantiated by relevant evidence" is not sufficient to justify the initiation of an investigation.[224] (Emphasis and italics in the original.)

While the Panel avoids the words 'objective' and 'even-handed', it clearly attributes to the IA the role of an impartial and objective arbiter: how should it otherwise perform either the 'balancing' or the other functions attributed to it by the Panel?[225] Regrettably, the practice does not always live up to that standard: IAs are almost always close to domestic industry. Certain common practices, such as reviewing draft complaints and giving feedback on whether or not the draft satisfies the required standards, raise serious questions as to their compatibility with the obligation to be objective and unbiased: How can it realistically be expected that the IA will distance itself easily from a document that it helped to shape?

Note, that the commercial harm resulting from CVD investigations occurs not just in the case of a (definitive or provisional) imposition of CVDs. Rather it is the public notice that entails the initial commercial disadvantage: from that point on, potential customers have to consider the significant risk that the (allegedly) subsidized product may become much more expensive (due to the added countervailing duties) or not available at all. This risk is either to be avoided ('we'll take our business elsewhere') or to be compensated ('you owe us'). It is for this reason that the SCM calls upon IAs to 'avoid, unless a decision has been made to initiate an investigation, any publicizing of the application for the initiation of an investigation'[226] and establishes strict timelines, preventing proceedings from going on indefinitely: any investigation shall be concluded within a year; in exceptional cases, the deadline is extended to eighteen months. In the reality of an intercontinental CVD examination (let's imagine Peruvian IA and Myanmar subsidies), this is a challenging time frame.

[222] *US—Offset Act (Byrd Amendment)* (Panel), para. 7.61; *Guatemala—Cement I* (Panel), para. 7.52.
[223] *US—Softwood Lumber V* (Panel), para. 7.84, referred to by *China—GOES* (Panel), para. 7.54.
[224] *China—GOES* (Panel), para. 7.55. [225] Ibid. [226] SCM Art. 11.5.

If, pursuant to SCM Article 11.9, the IA comes to the conclusion, that 'the amount of a subsidy is *de minimis*, or where the volume of subsidized imports, actual or potential, or the injury, is negligible', the investigation must be terminated. Note that the same provision defines a very low *de minimis* threshold of (less than) 1 per cent *ad valorem*.[227]

Pursuant to SCM Article 13, the importing member and the subsidizing exporting members may enter into consultations leading to a mutually agreed solution. Of course, these consultations may continue as long as the parties so wish. However, the required openness for engaging in such consultation is not supposed 'to prevent the authorities of a Member from proceeding expeditiously with regard to initiating the investigation, reaching preliminary or final determinations, whether affirmative or negative, or from applying provisional or final measures, in accordance with the provisions of this Agreement.'

Upon deciding that a formal investigation is being initiated,[228] the IA must allow the exporters of the allegedly subsidized products and the authorities of the exporting state to defend their interests by giving them access to the charge brought.[229] SCM Article 12 establishes the procedural framework for the investigation: it lays down a minimum standard of good administrative practice or procedural due process and defines the evidentiary rules applicable throughout the course of the investigation. The Appellate Body rightly recognizes 'due process rights that are enjoyed by "interested parties" throughout' an investigation.[230] Thus, maxims of good administration and fairness, such as transparency, *audiatur et altera pars*, right to a fair hearing, protection of confidential business information, and most importantly an 'effective right for parties to defend their interests' apply.[231] As the timeline is tight, the IA may not deviate from them to the detriment of the parties to the procedure.[232]

In this context, the question of sanctioning for non-participation arises. Pursuant to SCM Article 12.7,

> [i]n cases in which any interested Member or interested party refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation, preliminary and final determinations, affirmative or negative, may be made on the basis of the facts available.

In the past, several IAs sanctioned less than full cooperation by not using any information provided for by the investigated state and only used the data (readily) 'available', that is, for all practical purposes the ones provided by the complainants ('total facts available'); these datasets are regularly extremely unfavourable from the perspective of the exporters. The Appellate Body has put an end to this form of

[227] cf. *US—Carbon Steel* (Appellate Body), para. 83; *Mexico—Anti-Dumping Measures on Rice* (Appellate Body), para. 305.

[228] A duty to give public notice and to inform all interested parties follows from SCM Art. 22, paras. 1 and 2.

[229] cf. SCM Art. 12.1.3.

[230] *EC—Pipe Fittings* (Appellate Body), para. 138, quoting *EC—Bed Linen (Article 21.5—India)* (Appellate Body), para. 136 (referring to antidumping investigations).

[231] *China—GOES* (Appellate Body), para. 240, fn. 390.

[232] *Mexico—Anti-Dumping Measures on Rice* (Appellate Body), para. 283.

rough justice:[233] drawing on its pertinent jurisprudence regarding the Antidumping Agreement,[234] it clarified that using facts available serves the only purpose of replacing information that is missing,[235] and thus not as an instrument for sanctioning the less than fully cooperative party to the procedure.[236] Hence,

> recourse to facts available does not permit an investigating authority to use any information in whatever way it chooses. First, such recourse is not a licence to rely on only part of the evidence provided. To the extent possible, an investigating authority using the "facts available" in a countervailing duty investigation must take into account all the substantiated facts provided by an interested party, even if those facts may not constitute the complete information requested of that party. Secondly, the "facts available" to the agency are generally limited to those that may reasonably replace the information that an interested party failed to provide. In certain circumstances, this may include information from secondary sources.[237]

Pursuant to SCM Article 12.8, the IA shall, before a final determination is made, inform all interested members and interested parties of the essential facts under consideration which form the basis for the decision whether to apply definitive measures. Such disclosure should take place in sufficient time for the parties to defend their interests. In practice, many IAs, for different reasons, have a tendency to use that 'last stop' opportunity somewhat reluctantly, if only to avoid giving counsel for the investigated producers an opportunity to fine-tune their legal argumentation. The Appellate Body would have none of that: According to the Appellate Body the essential facts that an IA needs to communicate 'are those that are required to understand the basis for . . . the decision whether or not to apply definitive measures'.[238] Otherwise interested parties would not be able to defend their interests:

> As to the type of information that must be disclosed, these provisions cover "facts under consideration", that is, those facts on the record that may be taken into account by an authority in reaching a decision as to whether or not to apply definitive . . . countervailing duties. . . . Moreover, we note that Article . . . 12.8 do[es] not require the disclosure of *all* the facts that are before an authority but, instead, those that are "essential"; a word that carries a connotation of significant, important, or salient. In considering which facts are "essential", the following question arises: essential for what purpose? . . . [W]e understand the "essential facts" to refer to those facts that are significant in the process of reaching a decision as to whether or not to apply definitive measures. Such facts are those that are salient for a decision to apply definitive

[233] The US Supreme Court characterizes as 'rough' a form of justice that emphasizes 'summary procedures, speedy convictions and stern penalties'; cf. *Reid v Covert*, 354 U.S. 1 (1956), 35–6.

[234] *Mexico—Anti-Dumping Measures on Rice* (Appellate Body), para. 295: '. . . it would be anomalous if Article 12.7 of the *SCM Agreement* were to permit the use of "facts available" in countervailing duty investigations in a manner markedly different from that in anti-dumping investigations.'

[235] Ibid. para. 293, with further references.

[236] cf. *US—Oil Country Tubular Goods Sunset Reviews* (Appellate Body), para. 246 (concerning an antidumping investigation).

[237] *Mexico—Anti-Dumping Measures on Rice* (Appellate Body), para. 294.

[238] *China—GOES* (Appellate Body), para. 242.

> measures, as well as those that are salient for a contrary outcome. An authority must disclose such facts, in a coherent way, so as to permit an interested party to understand the basis for the decision whether or not to apply definitive measures.[239] (Emphasis and italics in the original.)

An 'essential fact' must therefore be understood in the light of the purpose of SCM Article 12.8: All factual findings that establish (or not) the substantive conditions for imposing definitive measures under the SCM Agreement are therefore 'essential' and have to be disclosed to interested parties.[240]

6.3 The *numerus clausus* of measures to be taken after the conclusion of CVD investigations

Pursuant to SCM Article 32, '[n]o specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement'.

The GATT and the SCM provide four remedies, of which one is not associated with the CVD investigation: The first option is the direct attack on the alleged subsidy in the WTO dispute settlement mechanism, which is of no further interest here. The remaining remedies are listed in SCM Articles 17 to 19. They are: (2) the provisional imposition of CVDs (SCM Article 17), (3) undertakings (SCM Article 18), and, lastly, (4) the definitive imposition of CVDs (SCM Article 19).

According to the Appellate Body, SCM Article 32 prohibits members from applying 'specific measures' 'against' subsidies, which are not covered by one of the last three categories. In its report on *US—Offset Act (Byrd Amendment)*, the Appellate Body decided that the US legislation introduced 'specific measures' 'against' subsidization. The measures were considered to be 'specific' because they were linked to CVD proceedings and 'against' because the measures had an adverse bearing on subsidies and did not feature among the permissible actions against subsidization (provisional or definitive CVDs).

> Because the CDSOA [the pertinent US legislation] has an adverse bearing on, and, more specifically, is designed and structured so that it dissuades ... the practice of subsidization, and because it creates an incentive to terminate such practices, the CDSOA is undoubtedly an action "against" dumping or a subsidy, within the meaning of Article 18.1 of the *Anti-Dumping Agreement* and of Article 32.1 of the *SCM Agreement*.[241] (Emphasis and italics in the original.)

In much the same way, certain fines imposed by Mexico were judged to be other than one of the three legal unilateral reactions to subsidies, and were therefore considered WTO-incompatible.[242] In contrast, the EC managed to convince the Panel in *EC—Commercial Vessels* that the measures in question were not directed

[239] Ibid. para. 240. [240] Ibid. paras. 240–2.
[241] *US—Offset Act (Byrd Amendment)* (Appellate Body), para. 256.
[242] *Mexico—Anti-Dumping Measures on Rice* (Panel), para. 7.278; but see the critique by Henrik Horn and Petros C. Mavroidis, 'United States—Continued Dumping and Subsidy Offset Act of 2000' in Henrik

'against' the subsidies.[243] However, it is probably too early to confidently evaluate the precedential value of that decision. Korea had argued that the EC's temporary defence mechanism (TDM) was in violation of SCM Article 32.1. Korea and the EC had reached an agreement on subsidization of their respective shipbuilding industries. Through the TDM, the EC intended to deviate from its commitments and grant subsidies to the ship-building sector, as Korea had not respected its own commitments in this respect.[244] The Panel agreed with the view that the TDM was a specific action, but acknowledged that it was not directed 'against' subsidization.[245] The Panel indicated that it would have come to a different conclusion, if the counter-subsidy had been funded through a transfer of financial resources between the foreign producer/exporter and the domestic competitor.[246]

6.4 Ending of the procedure by undertakings

Naturally, the investigation may lead to the result that the conditions elaborated above have not been satisfied. In that case, the IA makes a negative determination and the investigation comes to an end, SCM Article 12.12. Even if the determination is made that all requirements for the imposition of a CVD have been met,[247] the investigation may be concluded through a negotiated understanding, provided the investigating state and the other parties concerned find such an end to the proceedings preferable. This has become a common choice, as both sides may benefit from an earlier end to the proceedings: they obtain legal certainty, put a cap on legal costs, and avoid distraction from other tasks. SCM Article 18 lays down the relevant ground rules, trying to foster expediency, while protecting either side from being pressured into a bad deal.

6.5 Provisional imposition of CVDs

Pursuant to SCM Article 17.1, the IA may apply provisional CVDs even before the investigation has been completed, if such measures are 'judged to be necessary to prevent injury being caused during the investigation'. Provisional measures shall not be applied sooner than sixty days from the date of initiation of the investigation, SCM Article 17.3 and their application 'shall be limited to as short a period as possible, not exceeding four months', SCM Article 17.4.[248]

6.6 The imposition of definitive countervailing duties

6.6.1 Quantitative determination of CVDs

SCM Article 19 determines how to determine the 'level' of subsidies, by defining the parameters of permitted quantification.

Horn and Petros C. Mavroidis, eds., *The WTO Case Law of 2003, The American Law Institute Reporters' Studies* (Cambridge University Press, 2006) 52–86.

[243] *EC—Commercial Vessels* (Panel), paras. 7.172–7.173.
[244] The TDM Regulation is described in detail at ibid. para. 7.43.
[245] Ibid. paras. 7.154–7.174. [246] Ibid. para. 7.164. [247] cf. SCM Art. 18.2.
[248] cf. *US—Softwood Lumber III* (Panel), para. 7.101.

The purpose of CVDs—to undo any negative effect the subsidization by another member may have for domestic industries of the importing state—is reflected in SCM Article 19.2, which states:

> [It] is desirable that . . . the duty should be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry, and that procedures should be established which would allow the authorities concerned to take due account of representations made by domestic interested parties whose interests might be adversely affected by the imposition of a countervailing duty [footnote omitted].

The 'lesser duty rule' is not a rule, though, but rather a recommended option. Hence, irrespective of whether a lesser duty could offset the injury, WTO members can (and do) impose higher duties. If SCM Article 19.2 describes the desirable, least trade-affecting amount of a CVD, the maximum amount is determined by SCM Article 19.4:

> No countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product [footnote omitted].

In *Japan—DRAMs (Korea)* the Appellate Body agreed with the Panel that 'found to exist' had to be given its literal meaning: at the time of the imposition, subsidization must be taking place.[249] Unavoidably, that conclusion will not be based on live data, but rather on the data produced and used during the investigation.[250] That, however, should not affect the validity of a conclusion of current dumping, unless the data would show that the subsidies had been stopped.

6.6.2 Other legal questions related to imposition of CVDs

Pursuant to SCM Article 19.3, a countervailing duty

> shall be levied, in the appropriate amounts in each case, on a non-discriminatory basis on imports of such product from all sources found to be subsidized and causing injury, except as to imports from those sources which have renounced any subsidies in question or from which undertakings under the terms of this Agreement have been accepted. Any exporter whose exports are subject to a definitive countervailing duty but who was not actually investigated for reasons other than a refusal to cooperate, shall be entitled to an expedited review in order that the investigating authorities promptly establish an individual countervailing duty rate for that exporter.

Several brief remarks may give a first impression of the legal issues involved.

(1) First, SCM Article 19.3 allows WTO members to impose duties on an aggregate basis: all imports originating in a country found to be granting subsidies may be exposed to CVDs (rendering their market access more difficult), irrespective of whether they all benefited from subsidies.[251]

[249] *Japan—DRAMs (Korea)* (Appellate Body), para. 210. [250] Ibid. paras. 209–10.
[251] *US—Softwood Lumber IV* (Appellate Body), para. 152 *et seq*.

(2) Secondly, however, the obligation to impose CVDs on a non-discriminatory basis is couched in language which makes clear that the IA may distinguish between producers based on factual differences. Thus, a producer who renounced subsidies, or a producer whose offer of an undertaking was considered satisfactory will be treated differently from others.

(3) Note, thirdly, the right of IAs to sanction even *ex post facto* the non-cooperative exporter. Non-investigated exporters, on the other hand, have the right to request an expedited review to establish their individualized rate (if any).

(4) Lastly, the Appellate Body has used the language of SCM Article 19.3 as the *sedes materiae* for the obligation of members not to countervail twice. The same outcome would also follow from a holistic view of both the SCM and the Antidumping Agreement, which contain numerous provision granting (procedural)[252] due process rights; one could derive from this an obligation to analyse and counteract subsidies and dumping fairly and squarely. However, the Appellate Body looked for a specific hook to reject the imposition of a 'double burden' on products from non-market economies (NME); it held that 'the offsetting of the same subsidization twice by the concurrent imposition of anti-dumping duties calculated on the basis of an NME methodology and countervailing duties'[253] was incompatible with SCM Article 19.3:

> Under Article 19.3 of the *SCM Agreement*, the appropriateness of the amount of countervailing duties cannot be determined without having regard to anti-dumping duties imposed on the same product to offset the same subsidization. The amount of a countervailing duty cannot be "appropriate" in situations where that duty represents the full amount of the subsidy and where anti-dumping duties, calculated at least to some extent on the basis of the same subsidization, are imposed concurrently to remove the same injury to the domestic industry. Dumping margins calculated based on an NME methodology are, for the reasons explained above, likely to include some component that is attributable to subsidization.[254]

In line with the purpose of CVDs to nullify the ongoing damage to the domestic industry—rather than compensating or sanctioning for past damages—countervailing measures cannot be imposed retroactively, except under the rather strict conditions laid down in SCM Article 20, in particular its paragraph 2. SCM Article 20.3 to 20.5 orders the recipient state of bonds and deposit to reimburse 'in an expeditious manner', if the final duty owed is lesser than the security given.[255]

[252] As opposed to substantive due process rights, cf. Mark Tushnet, 'The Newer Property: Suggestion for the Revival of Substantive Due Process' (1975) *The Supreme Court Review*, 261–88. Available at <http://www.jstor.org/stable/3108813>.

[253] *US—Anti-Dumping and Countervailing Duties (China)* (Appellate Body), para. 583, rejecting *US—Anti-Dumping and Countervailing Duties (China)* (Panel), para. 14.128 *et seq.*

[254] *US—Anti-Dumping and Countervailing Duties (China)* (Appellate Body), para. 582.

[255] cf. *US—Softwood Lumber III* (Panel), para. 7.94.

6.6.3 *Review of countervailing duties*

SCM Article 21.1 states that CVDs will only remain in place as long as and to the extent necessary to counteract injurious subsidization.

> We see this as a general rule that, after the imposition of a countervailing duty, the continued application of that duty is subject to certain disciplines. These disciplines relate to the *duration* of the countervailing duty ("only as long as . . . necessary"), its *magnitude* ("only . . . to the extent necessary"), and its *purpose* ("to counteract subsidization which is causing injury").[256] (Emphasis and italics in the original.)

This 'general rule'[257] is rendered operational through the two types of review provided for in the following paragraphs: the sunset and the administrative[258] review.

6.6.3.1 The sunset review

According to SCM Article 21.3, all countervailing measures have to be withdrawn five years after their imposition, unless the WTO member concerned has conducted a review (sunset review). In *US—Carbon Steel*, the Appellate Body confirmed the significance of such review: If the member 'does not conduct a sunset review, or, having conducted such a review, it does not make such a positive determination, the duties must be terminated'.[259] While the starting point for counting the five-year period is not necessarily that of the original imposition, the member concerned should take into account that an

> automatic time-bound termination of countervailing duties that have been in place for five years from the original investigation or a subsequent comprehensive review is at the heart of this provision. Termination of a countervailing duty is the rule and its continuation is the exception. The continuation of a countervailing duty must therefore be based on a properly conducted review and a positive determination that the revocation of the countervailing duty would "be likely to lead to continuation or recurrence of subsidization and injury." Where the level of subsidization at the time of the review is very low, there must be persuasive evidence that revocation of the duty would nevertheless lead to injury to the domestic industry. Mere reliance by the authorities on the injury determination made in the original investigation will not be sufficient.[260]

The treatment of sunset reviews has attracted substantial interest in the ongoing Doha Round of multilateral negotiations. A group of WTO members called Friends of Antidumping, have issued a series of papers illustrating the undesirable consequences of the existing regime. As things stand, practice confirms that (both in antidumping and in countervailing investigations) the majority of sunset reviews end up with a decision in favour of continued imposition: between 1998 and 2003, 54 per cent of all

[256] *US—Carbon Steel* (Appellate Body), para. 70. [257] Ibid.
[258] We use the term *administrative* review in line with, for example, *US—Lead and Bismuth II* (Appellate Body), para. 62. In US practice this term describes the annual review undertaken in order to control the appropriateness of the provisional deposits required for importation.
[259] *US—Carbon Steel* (Appellate Body), para. 63. [260] Ibid. para. 88.

orders were extended in the United States, the corresponding number for the EC during the same period reached 60 per cent.[261]

6.6.3.2 The administrative review

SCM Article 21.2 makes provision for an administrative review. It can be initiated either *ex officio*, provided that a reasonable time since the imposition of CVDs has lapsed, or upon request by an interested party, at any time following the original imposition. The subject matter of an administrative review does not necessarily overlap with that of a sunset review. Irrespective whether it has been initiated *ex officio* or upon request, an investigating authority shall investigate whether:

(a) the continued imposition of duties is necessary to offset subsidization; or whether
(b) the damage would be likely to recur if the duty in place were removed; or whether
(c) subsidization resulting in damage will continue/recur, assuming that the duties in place were to be removed.

The Appellate Body, in its report on *US—Carbon Steel*, was of the view that, whereas in the context of an administrative review the submission of positive evidence is a threshold issue to initiate the review at the request of an interested party, an *ex officio* initiation does not have a similar requirement:

> Article 21.2 differs from Article 21.3 in that the former identifies certain circumstances in which the authorities are under an *obligation* to review ("shall review") whether the continued imposition of the countervailing duty is necessary. In contrast, the principal obligation in Article 21.3 is not, *per se*, to conduct a review, but rather to *terminate* a countervailing duty *unless* a specific determination is made in a review. We note that Article 21.2 sets down an explicit evidentiary standard for requests by interested parties for a review under that provision. In order to trigger the authorities' obligation to conduct a review, such requests must, *inter alia*, include "positive information substantiating the need for review". Article 21.2 does not, on its face, apply this same standard to the initiation by authorities "on their own initiative" of a review carried out under that provision. Thus, Article 21.2 contemplates that, for reviews carried out pursuant to that provision, the self-initiation by the authorities of a review is not governed by the same standards that apply to initiation upon request by other parties.[262] (Italics and emphasis in the original.)

This passage does not explain what the applicable standards are, in the context of an *ex officio* review.[263] Progress, however, has been made regarding the relevance of *de minimis* standards in the context of administrative reviews. In *US—Carbon Steel*, the

[261] See WTO Doc. TN/RL/W/111 of 27 May 2003.
[262] *US—Carbon Steel* (Appellate Body), para. 108.
[263] Note that this issue has been quite thorny in GATT/WTO adjudication since GATT Panel report, *United States—Anti-Dumping Duties on Imports of Stainless Steel Plate from Sweden*, ADP/117 and Corr. 1, 24 February 1994, unadopted.

Appellate Body clarified that when reviewing duties, WTO members do not have to abide by the *de minimis* thresholds of SCM Article 11.9, pursuant to which duties cannot be imposed if a subsidy is less than 1 per cent *ad valorem*. The US legislation governing reviews imposed a 0.5 per cent *ad valorem* threshold for a subsidy to be countervailable. The Appellate Body concurred with the United States and reversed the Panel's pertinent findings.[264]

In *US—Lead and Bismuth II*, the Appellate Body decided that in the context of an administrative review, an investigating authority does not need to show that a benefit will continue to be conferred to the subsidized entity (beyond demonstrating recurrence of subsidization and/or damage). It made a distinction between the obligation to establish existence of a benefit conferred by a subsidy during the original investigation and in the subsequent administrative review. According to the Appellate Body, an IA might legitimately presume that this will indeed be the case assuming subsidization continues.[265] However, this presumption may be rebutted. In a case of change of ownership, an IA should review whether a benefit would continue to exist. In *US—Countervailing Measures on Certain EC Products*, the Appellate Body further clarified this position. In the case at hand, it dealt with the so-called same person methodology applied by the United States when reviewing the need for continued imposition of CVDs:

> [U]nder the "same person" method, when the USDOC determines that no new legal person is created as a result of privatization, the USDOC will conclude from this determination, *without any further analysis*, and irrespective of the price paid by the new owners for the newly-privatized enterprise, that the newly-privatized enterprise continues to receive the benefit of a previous financial contribution. This approach is contrary to the obligation in Article 21.2 of the *SCM Agreement* that the investigating authority must take into account in an administrative review "positive information substantiating the need for a review." Such information could relate to developments with respect to the subsidy, privatization at arm's length and for fair market value, or some other information. The "same person" method impedes the USDOC from complying with its obligation to examine whether a countervailable "benefit" continues to exist in a firm subsequent to that firm's change in ownership. Therefore, we find that the "same person" method, *as such*, is inconsistent with the obligations relating to administrative reviews under Article 21.2 of the SCM Agreement.[266] (Emphasis and italics in the original.)

It follows, thus, that the US investigating authority will never, in the context of an administrative review, be in a position to examine whether a benefit continues to exist, even if presented with evidence to this effect. Consequently, what should be a rebuttable presumption, becomes irrebuttable. This is why the Appellate Body found that the relevant US legislation was in violation of SCM Article 21.2.

[264] *US—Carbon Steel* (Appellate Body), paras. 88 *et seq.*, 91–3; cf. Gene Grossman and Petros C. Mavroidis, 'The Sounds of Silence' in Henrik Horn and Petros C. Mavroidis, eds., *The WTO Case Law of 2002* (Cambridge University Press 2005) 64–77.

[265] *US—Lead and Bismuth II* (Appellate Body), paras. 59–63.

[266] *US—Countervailing Measures on Certain EC Products* (Appellate Body), para. 146.

6.7 Judicial review

Once an affirmative decision to impose CVDs has been taken, IAs have to issue

> a public notice of conclusion . . . [, which] shall contain, or otherwise make available through a separate report, all relevant information on the matters of fact and law and reasons which have led to the imposition of final measures or the acceptance of an undertaking, due regard being paid to the requirement for the protection of confidential information.[267]

The notice—or report—shall contain the reasons for the acceptance or rejection of relevant arguments or claims made by interested members and by the exporters and importers; in addition it shall contain the following information, listed in SCM Article 22.4:

(i) the names of the suppliers or, when this is impracticable, the supplying countries involved;
(ii) a description of the product which is sufficient for customs purposes;
(iii) the amount of subsidy established and the basis on which the existence of a subsidy has been determined;
(iv) considerations relevant to the injury determination as set out in Article 15;
(v) the main reasons leading to the determination.

Pursuant to SCM Article 23, members that have legislation on CVD proceedings in place

> shall maintain judicial, arbitral or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review of administrative actions relating to final determinations and reviews of determinations within the meaning of Article 21. Such tribunals or procedures shall be independent of the authorities responsible for the determination or review in question, and shall provide all interested parties who participated in the administrative proceeding and are directly and individually affected by the administrative actions with access to review.

7. Special and Differential Treatment

SCM Article 27 establishes preferential rules for developing and least developed countries. This concerns both substantive rules—for instance, exceptions as to the absolute prohibition of export subsidies, pursuant to paragraphs 2 and 3, and a number of favourably altered thresholds—and the dispute settlement procedure.

8. Institutional Set-up

In its Article 24, the SCM sets up a Committee on Subsidies and Countervailing Measures, in which all members of the WTO are *ipso facto* represented. Pursuant to

[267] SCM Art. 22.5.

SCM Article 24.3, the Committee is tasked with establishing a permanent group of experts (PGE).

According to SCM Article 25, members are obliged to notify to the Committee subsidies (Article 25.1), CVDs (Article 25.11), competent authorities (Article 25.12), new and full subsidy notifications (Article 25.1), special and differential treatment for developing countries (Article 27), and laws and regulations (Article 32.6). Pertinent rule abidance has been heterogeneous: a fairly significant number of members have not implemented their pertinent obligations.

11

Antidumping

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1. What is Dumping?

The term 'dumping' has many meanings. It may mean exporting a product at an unduly low price to drive out competition in the importing country. It may also mean 'social dumping', exporting a product from a country where wages are extremely low (and, therefore, where the export price is low) or where the level of working conditions is far below that of advanced countries. Whatever the term dumping means, it has the connotation of 'unfair' or 'predatory'.[1] On the other hand, there is a view that 'dumping' is merely legitimate price competition.

[1] On predatory pricing, see generally Robert Bork, *Antitrust Paradox: A Policy at War with Itself* (Basic Books, Inc., 1978); Joseph Brodley and George A. Hay, 'Predatory Pricing: Competing Economic Theories and the Evolution of Legal Standards' (1981) *Cornell L. Rev.* 66, 739; Frank H. Easterbrook, 'Predatory Strategies and Counterstrategies' (1981) *U. Chi. L. Rev.* 48, 263; Paul R. Krugman, ed., *Strategic Trade Policy and the New International Economics* (MIT Press, 1986); Richard A. Posner, *Antitrust Law: An Economic Perspective* (Chicago University Press, 1976); and Laura D. A. Tyson, *Who's Bashing Whom: Trade Conflict in High Technology Industries* (Institute of International Economics, 1992).

1.1 Dumping as sales below cost

Dumping may take the form of sales below cost. Sales below cost are defined in the legislation of many nations as sales of a product at prices below the cost of production (including indirect expenses). Sales below cost can occur in various circumstances.

First, intense competition in a market may result in sales below cost. If competition in a market is fierce, the mark-up tends to be small, below the marginal cost of production.

Second, a decline in demand in a market due to a recession may lead to sales below cost. This is true especially in industries, such as the steel industry, in which the fixed cost of production is high. When a recession hits the steel industry, the demand for steel declines, and the production capacity in the market becomes excessive in relation to that demand. When sales volume declines due to a recession, the average total costs increase due to an increase in the fixed cost per unit of products. This increase in the fixed cost per unit tends to push down the market price below the cost of production.

Third, forward pricing may result in sales below cost. Forward pricing is the practice of pricing goods below cost to increase sales volumes early in a product's life cycle and maximize profitability over the full life cycle of the product. In industries that require a huge amount of money to develop a product, the initial cost of production is so great that sales of the new product at prices above cost would be prohibitive. Under these circumstances, the only marketable price of the new product would be one below the cost of production. Enterprises therefore sell the product at prices below the cost of production expecting that the cost of production will decline sharply as the product is mass-produced and sold and that profit will be made later.[2]

Finally, predatory pricing may cause sales below cost. Predatory pricing is the practice of an enterprise with market power engaging in sales below the cost of production to drive out the competition and to gain a monopoly. Predatory pricing may occur if an enterprise has a reasonable expectation that the profits lost to sales below cost can be recouped by raising prices after competitors have been driven from the market. An enterprise has this expectation only when it has market power, when the market is concentrated, and when other enterprises cannot easily enter the market to compete with it.

Predatory pricing is commonly illegal under national competition laws, but more than below cost sales must be proved. For example, under US antitrust laws, the requirements for a prima facie case of predatory pricing include: (1) proof that the enterprise engages in sales below cost; (2) proof that the sales below cost harm competition; and (3) proof that the enterprise engaging in predatory pricing has a reasonable prospect of recouping the money it lost by earning monopoly profits after driving competitors out, establishing market power, and raising prices.[3] The rationale

[2] See Tyson, *Who's Bashing Whom*, n. 1 at 57–9.

[3] For major cases, see *In re Japanese Electronics Products Antitrust Litigation*, 513 F. Supp. 1100 (E.D. Pa. 1981), affirmed in part, reversed in part, 723 F.2d 238 (3d Cir. 1983), reversed and remanded, 475 U.S. 574 (1986); *Marsann Co. v Brammall, Inc.*, 788 F.2d 611 (9th Cir. 1986); *A. A. Poultry Farms v Rose Acre Farms*, 881 F.2d 1396 (7th Cir. 1989); *Liggett Group v Brown & Williamson Tobacco*, 748 F. Supp. 344 (M.D.N. C. 1990), affirmed, 964 F.2d 335 (4th Cir. 1992), affirmed, 509 U.S. 209 (1993).

for the additional requirements is that an enterprise is presumed to behave rationally, that is, in such a way as to maximize profit. Moreover, the burden of proof of predatory pricing is on the party challenging the conduct.[4] Consequently, a case of predatory pricing is very difficult to prove.[5]

1.2 Dumping as international price discrimination

Another form of dumping is international price discrimination. International price discrimination occurs when an enterprise sells the same product at different prices in different areas or to different customers. In the international arena, price discrimination usually takes the form of selling the same or a similar product at different prices in the domestic market and an export market, that is, international price discrimination based on geography.

International price discrimination can occur when the markets of the exporting country and the importing country are relatively isolated (for example, by high tariffs, quotas, or private restrictive business practices such as exclusive dealing arrangements, tie-in contracts, boycotts, or other forms of anti-competitive practices). Products exported at a price lower than the price charged in the exporting country will be re-exported to the importing country unless (1) the market of the exporting country is insulated from that of the importing county; or (2) costs of transportation and other sales expenses are significant factors that prevent such a re-export from occurring.

International price discrimination can also occur when there are significant differences in elasticity of demand between different countries. If, for example, the demand for a product in the market of the exporting country is inelastic, a seller of the product in the market of the exporting country has incentive to charge higher prices in that market while charging lower prices to customers in the importing country, where demand for the product is elastic.

1.3 Duration

Dumping can be classified by duration into sporadic, intermittent, and continuous (persistent) activity. While sporadic dumping generally is not worrisome, intermittent or continuous dumping may produce adverse welfare effects if it is designed to be predatory, to drive competitors out of business. Dumping of longer duration also may result in a misallocation of resources, especially in the *exporting* country.

1.4 Cost analysis

Dumping may be analysed in terms of the relationship of prices to costs of production. Consider five cases of prices in the export market: (1) P1 is a price higher than average total cost as well as the equilibrium point of marginal revenue (MR) and marginal cost

[4] *Japanese Electronic Products Antitrust Litigation*, n. 3, 475 U.S. at 585. [5] Ibid. 586.

(MC); (2) P2 is the equilibrium of marginal revenue and marginal cost, above average total cost; (3) P3 is below average total cost but above average variable cost; (4) P4 is below average variable cost; and (5) P5 is below average fixed cost. In each case, the home market price is higher.

All five cases would meet the legal definition of dumping. Certainly, however, P1 and P2 can be defended as normal and rational behaviour; any price above average total cost is profitable. P2, which is equal to marginal cost, or short-run variable costs, is the proper basis for efficient output decisions and by definition is efficient pricing.

On the other hand, prices below average total cost cause the firm to incur losses. This may be rational, however, in periods of slack demand or for other economic reasons. Dumping below average total cost or marginal cost may be justified by uncertainties and the necessity to make decisions about production before prices can be determined. A firm may also be meeting competition, competing for market share, or trying to maximize sales rather than profits. In antitrust cases, prices above average total cost are legal per se, average variable cost is a marker of rebuttable presumptions, with the plaintiff holding the burden above and the defendant below.[6] Only P5, pricing below fixed cost, seems irrational, except where it occurs for very short periods.

1.5 Welfare effects

The welfare effects of dumping are mixed. Perhaps the greatest impact is in the exporting country, where consumers must pay more in an artificially segmented market. Some have called for antidumping duties to punish the exporting country for maintaining closed markets.[7]

In the importing country, consumers will be better off paying less, but producers will be disadvantaged. Third-country producers also will be at a disadvantage, as well as certain producers of products that are not directly competitive with the dumped imports through the misallocation of resources stimulated by artificially low prices. The seriousness and extent of the injuries may vary greatly.

1.6 Measures to counteract dumping

To counteract dumping, countries impose ‘antidumping’ duties on imports of the products that are being dumped. As explained below, an importing country may impose an antidumping duty on imported products if (1) products are sold at a certain price in the domestic market of the exporting country and such products or similar products are sold at a lower price in the market of the importing country; (2) a domestic industry in the importing country is materially injured; and (3) there is a causal relationship between dumping and the material injury. The maximum duty that may be imposed under WTO rules is the difference between those two prices.[8]

[6] See *Henry v Chloride Inc.*, 809 F.2d 1334, 1346 (8th Cir. 1987).

[7] See Jeffrey E. Garten, ‘New Challenges in the World Economy: The Antidumping Law and U. S. Trade Policy’ (1994) *World Competition* 17(4), 129.

[8] GATT 1994 Art. VI; Antidumping Agreement.

Although WTO rules condemn dumping,[9] whether antidumping is a good policy or not is a controversial matter. Some argue that antidumping measures are necessary to counteract unfair trade on the part of exporters. Others argue that antidumping measures are often used to protect domestic industries from competition from imports and are themselves unfair.[10]

2. The Regulation of Antidumping Duties

2.1 The legal framework of antidumping in the GATT/WTO regime

It is quite remarkable that, despite a consensus among economists and lawyers that the antidumping laws are seriously flawed,[11] serious reform has proved difficult or impossible to achieve. The GATT Antidumping Code of 1979[12] introduced new procedural and substantive standards both for calculating dumping margins and for determining whether a domestic industry is materially injured, but abuses by protectionist interests increased in the 1980s.[13] The Uruguay Round of trade negotiations produced a new Antidumping Agreement, but since this latest 'reform', the use and abuse of antidumping actions has continued unabated, especially in the United States, the European Union (EU), India, and Brazil.

The legal framework of antidumping in the GATT/WTO regime consists of GATT 1994 Article VI and the Antidumping Agreement. GATT 1994 Article VI is the general provision and the Antidumping Agreement is an implementation of Article VI.

2.1.1 GATT Article VI

GATT 1994 Article VI reads, in the relevant part, as follows:

> The contracting parties recognize that dumping, by which products of one country are introduced into the commerce of another country at less than the normal value of the products, is to be condemned if it causes or threatens material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry.[14]

[9] GATT 1994 Art. VI.

[10] For different views on antidumping, see S. P. Anderson et al., 'Who Benefits from Antidumping Legislation?' (1995) *J. Int'l Econ.* 38, 321; H. K. Gruenspecht, 'Dumping and Dynamic Competition' (1988) *J. Int'l Econ.* 25, 225; R. Pierce, 'Antidumping Law as a Means of Facilitating Cartelization' (2000) *Antitrust L.J.* 67, 725; U.S. Int'l Trade Comm'n, '*The Economic Effects of Antidumping and Countervailing Duty Order and Suspension Agreements*, Investigation Nos. 332–344', USITC Publication 2900 (June 1995).

[11] See generally Richard Botlick and Robert Litan, eds., *Down in the Dumps: Administration of the Unfair Trade Laws* (Kluwer Law International, 1991); Eberhard Grabitz and Armin von Bogdandy, eds., *U.S. Trade Barriers: A Legal Analysis* (Martinus Nijhoff, 1991); Jagdish Bhagwati, *Protectionism* (MIT Press, 1988).

[12] Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade, GATT Doc. l MTN/NTM/W/232, GATT B.I.S.D. (26th Supp.) at 171 (1980).

[13] See generally Thomas J. Schoenbaum, 'Antidumping and Countervailing Duties and the GATT: An Evaluation and a Proposal for a Unified Remedy for Unfair International Trade' (1988) *German Y.B. Int'l L.* 30, 177.

[14] GATT Art. VI:1.

According to this provision, there are three requirements for dumping. First, the export price of a product must be lower than the price (normal value) of that product in the domestic market of the exporting country. Second, exports of such products must (1) cause or threaten to cause material injury to a domestic industry; or (2) materially retard the establishment of a domestic industry. Third, there must be a causal relationship between dumping and the injury or retardation. The GATT contracting parties agreed that dumping, in this sense, is an unfair trade practice.

GATT Article VI:6(a) addresses the injury determination. Under this Article, national antidumping authorities may impose an antidumping duty only after first determining that the dumping causes or threatens material injury to an established domestic industry or materially retards the establishment of a domestic industry.

2.1.2 The Antidumping Agreement

Although GATT 1994 Article VI sets forth the basic principles to be followed by WTO members when dealing with dumping issues, its terms are general and the content is rather sketchy. When trade negotiations took place in the Kennedy and Tokyo Rounds, the negotiators thought it necessary to conclude an additional agreement on anti-dumping issues to clarify the meanings of some of the key concepts of the GATT and to provide practical guides for the enforcers of antidumping legislation of member countries and for exporters whose products may be subject to antidumping duty.

The Antidumping Agreement is formally titled 'Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994'. For the sake of brevity, the term 'Antidumping Agreement' is used in this work. It is clear from this title that the Antidumping Agreement is an agreement whose purpose is to implement (clarify and amplify) the provisions of the GATT. There follows an explanation of some of the important provisions of Article VI and the Antidumping Agreement.

2.1.3 Institutions and notifications

The Antidumping Agreement establishes a Committee on Antidumping Practices composed of representatives of all WTO members. The function of the Committee is to seek information and provide a forum for consultation among members. All preliminary and final antidumping actions taken by members must be promptly notified to the Committee.

2.1.4 Developing countries

The interests of developing country members are addressed in Article 15 of the Antidumping Agreement. Article 15 reads as follows:

> It is recognized that special regard must be given by developed country Members to the special situation of developing country Members when considering the application of anti-dumping measures under this Agreement. Possibilities of constructive remedies

provided for by this Agreement shall be explored before applying anti-dumping duties where they would affect the essential interests of developing country Members.

This provision is vague and somewhat ambiguous. In the *EC—Bed Linen* case, the Panel ruled that the EC had violated Article 15 by failing to explore the possibility of 'constructive remedies' in the form of price undertakings.[15]

Much could be done to improve 'special and differential treatment' for developing countries in antidumping cases. There could, for example, be special rules for initiating an investigation, and special import share and *de minimis* thresholds for developing countries.[16]

2.2 Investigation

2.2.1 Initiating an investigation

National antidumping authorities may initiate an antidumping investigation when a domestic industry files a petition or on their own.[17] The petition must include evidence of dumping, material injury, and causation that is 'reasonably available' to the petitioner.[18] This requirement is set out in Article 5.2 of the Antidumping Agreement. WTO Panels have concluded that, while Article 5.2 requires a petitioner to submit data that provides evidence of dumping, Article 5.2 does not require a petitioner to explain such data.[19]

To prevent abuse of antidumping proceedings, the Antidumping Agreement provides that national antidumping authorities may accept a petition only when there is evidence to show that a domestic industry or a person representing the industry has filed the petition.[20] If a petition is supported by domestic producers that account for more than 50 per cent of domestic production of the domestic product of domestic producers that have expressed views on the petition, *either for or against the petition*, the petition is considered to have been made by a domestic industry or a person representing the industry.[21] If, however, domestic producers supporting the petition account for less than 25 per cent of domestic production, national antidumping authorities may not initiate an investigation.[22]

These rules were incorporated into the Antidumping Agreement in the Uruguay Round to ensure that a petitioner properly represents the majority of the domestic

[15] Panel report, *EC—Bed Linen*, paras. 65–9. In a recent antidumping dispute case (*US—Anti-Dumping and Countervailing Measures on Steel Plate from India*, Report of the Panel, adopted 29 July 2002, WT/DS206/R), the Panel noted that, under Art. 15 of the Antidumping Agreement, members are under no obligation to take any action. As stated by the Panel, Art. 15 of the Antidumping Agreement imposes on members 'no specific and general obligation' to take action, however, under this provision, members are obligated to 'explore' possibilities for constructive remedies when, in an antidumping dispute, a developing country is the target of an antidumping measure.

[16] See Konstantinos Adamantopolous and Diego De Notaris, 'The Future of the WTO and the Reform of the Anti-dumping Agreement: A Legal Perspective' (2000) *Fordham Int'l L. J.* 30, 46, 58–9.

[17] Antidumping Agreement Art. 5.1 and 5.7. [18] Antidumping Agreement Art. 5.2.

[19] Panel report, *Thailand—H-Beams*. A similar ruling was made by the Panel in *Mexico—Corn Syrup (HFCS)*.

[20] Antidumping Agreement Art. 5.4. [21] Ibid. [22] Ibid.

industry. In the past, there were cases in which national antidumping authorities initiated antidumping investigations even though it was not clear whether the petitioner properly represented the domestic industry injured by dumping.[23]

2.2.2 Evidential issues

The application must contain 'sufficient evidence' of the existence of dumping that causes or threatens to cause injury to a domestic industry.[24]

Article 6 of the Antidumping Agreement addresses evidentiary issues that arise in antidumping cases. Interested parties (exporters, importers, and domestic producers) are guaranteed the opportunity to receive notice, produce evidence, and express their views on the matter in question. In general, evidence produced must be open to the public, but when the provider requests confidentiality, it is kept confidential, except that the provider must prepare a non-confidential summary of the confidential information.[25]

When persons from whom information is sought refuse to provide it or otherwise block the investigation, national antidumping authorities may proceed with the investigation and make decisions on the basis of 'facts available', which includes information provided by the petitioner.[26] In *Guatemala—Cement*, an issue arose as to the meaning of 'best information available', which is the same as 'facts available'.[27] In this case, the Mexican antidumping authority based its finding that products from Guatemala were dumped on the 'best information available' because many key facts submitted by the parties could not be verified. According to the *Guatemala—Cement* Panel, Article 6.8 of the Antidumping Agreement permits the use of facts available for determining dumping if an interested party (1) refuses access to necessary information; (2) otherwise does not provide necessary information; or (3) significantly impedes the investigation.[28] The Panel found that a mere failure to cooperate on the part of a party to the investigation did not entitle the antidumping authority to resort to the 'best information available' approach.[29]

'Facts available' was also an issue in *US—Hot-Rolled Steel from Japan*.[30] In this case, one of the petitioners was a US company jointly owned by a Japanese exporter (one of the respondents in the US antidumping proceeding) and a Brazilian company. The US antidumping authority asked the Japanese exporter to submit evidence that was in the possession of its US joint venture. The Japanese exporter could not submit this evidence because the joint venture entity refused to supply it. The US antidumping authority decided that the Japanese exporter was not cooperative in submitting evidence and therefore resorted to a 'facts available' methodology. Japan appealed this

[23] See, for example, *United States Antidumping Duty on Stainless Steel Pipe from Sweden*, 20 August 1990, GATT Doc. ADP/47 (unadopted).

[24] Antidumping Agreement Art. 5.3. [25] Ibid. Art. 6.5.

[26] Ibid. Art. 6.8. [27] Ibid. Annex II, Art. 2.1.

[28] *Guatemala—Definitive Antidumping Measures Regarding Grey Portland Cement from Mexico*, report of the Appellate Body.

[29] Ibid. [30] See Appellate Body report, *US—Hot-Rolled Steel from Japan*.

determination, and the Appellate Body ruled that the US antidumping authority was wrong in utilizing a fact available approach because the Japanese exporter could not be said to be uncooperative in light of the joint venture's refusal to supply the information.[31]

Thus, national antidumping authorities must carefully adhere to WTO standards when assembling evidence. Parties can be required to produce evidence, but exporters and foreign producers must be given at least thirty days to reply to questionnaires.[32] The 'facts available' approach allowing the use of evidence proffered by the domestic industry is a last resort. There must be specific findings of the conditions specified in Article 6.8 and Annex II of the Antidumping Agreement.[33] National antidumping authorities cannot utilize 'facts available' solely because information was provided by the exporter after the deadline for response because Article 6.8 requires a 'reasonable period' for response beyond the thirty-day minimum.[34]

2.2.3 The duties of the investigating authority

The Antidumping Agreement sets a maximum period for an antidumping investigation because prolonged investigations are burdensome to exporters and importers and impede imports unduly. Investigations must generally be conducted within one year and may not exceed eighteen months.[35]

2.3 Determination of dumping

To determine whether a product is dumped, the antidumping authority of the importing country must determine whether there is a difference between the export price and the normal value (domestic price) of the product.[36] If the difference is slight (less than 2 per cent of the export price), national antidumping authorities must terminate the investigation (the *de minimis* rule). Antidumping authorities must also terminate the investigation if the volume of imports of the dumped product is negligible (for example, less than 3 per cent of imports of the like product).[37]

Comparing the normal value and the export price is complicated. To be compared fairly, the normal value and the export price must be compared at the same 'level of trade' or, if this is not possible, at levels as close as possible.[38] A comparison between

[31] Appellate Body report, *US—Hot Rolled Steel from Japan*. For recent Panel rulings on facts available, see the following: *US—Anti-Dumping and Countervailing Measures on Steel Plate from India*, report of the Panel, 29 July 2002, WT/DS206/R; *Egypt—Definitive Anti-Dumping Measures on Steel Rebar from Turkey*, report of the Panel, 1 October 2002, WT/DS211/R.

[32] Antidumping Agreement Art. 6.1.1.

[33] See Panel report, *Argentina—Definitive Anti-Dumping Measures on Imports of Ceramic Floor Tiles from Italy*. The Panel found a violation because the exporter's information was rejected without giving a reason.

[34] Appellate Body report, *US—Hot-Rolled Steel from Japan*.

[35] Antidumping Agreement Art. 5.3 and 5.10.

[36] Ibid. Art. 2.1.

[37] Ibid. Art. 5.8. There is an exception to this rule if the volume of dumping imports from countries that individually account for less than 3 per cent collectively account for more than 7 per cent of imports of the like product into the importing country, the investigation may go ahead.

[38] Antidumping Agreement Art. 2.4.

the domestic price and the export price of the product in question should, in principle, be made at the same level of transaction (for example, at the ex-factory level).

In addition, various circumstances of sale affect the price level. For example, suppose a foreign purchaser pays for a product by letter of credit payable on sight, and a domestic purchaser pays for the same product by a promissory note payable after six months. The seller can get paid in cash from the foreign purchaser immediately after receiving the letter of credit, whereas he cannot get paid in cash until six months after receiving the promissory note. The seller is, therefore, justified in charging more to the domestic purchaser than the foreign purchaser, at least to the extent of interest that he would obtain if the domestic purchaser paid cash.

Other circumstances of sale may justify a difference in domestic and export prices. In comparing the domestic price and the export price of a product, national antidumping authorities must consider all such circumstances. GATT Article VI provides: 'Due allowance shall be made in each case for differences in conditions and terms of sale, for differences in taxation, and for other differences affecting price comparability'.

2.3.1 Like product

The 'like product' issue is typically quite important in antidumping cases. The issue arises principally in three contexts. First, dumping involves a comparison of the prices of 'like products' in the domestic market of the exporting country and the export market.[39] There may be some differences in the characteristics of the products sold in the two markets. These differences, in turn, may be due to various business purposes: (1) the product may be modified to suit individual markets; (2) the product may be modified for sale in the export market to circumvent a previous antidumping order or investigation; or (3) the product may be sold finished in one market and in a 'kit' for assembly by the buyer in another market. No WTO antidumping case has considered the 'like product' issue, but from the consideration of this issue in other GATT 1994 contexts,[40] a determination would be made on a case-by-case basis. In all of the above contexts, the products would be considered 'like' in the majority of cases by national antidumping authorities, and this determination would probably be upheld by the WTO.[41]

Second, the 'like product' issue may come up in a context in which a foreign manufacturer buys product components at below cost prices from an unrelated supplier and assembles them into a product for resale in domestic and export markets. This is known as 'downstream dumping'. Although no GATT or WTO case has arisen on this issue, it would seem that the 'like product' issue would prevent the imposition of national antidumping duties in this case because the manufacturer selling below cost is not selling the product in the export market, and the manufacturer who is selling in the

[39] Ibid. Art. 2.1.

[40] See especially the national treatment cases in Chapter 8.

[41] In the Antidumping Agreement Art. 2.6, a 'like product' does not have to be identical but can be similar.

exporter market is not dumping with respect to the exported product. 'Downstream dumping' may have to be considered by the Committee on Antidumping Practices.

Third, the 'like product' issue may arise in the context of defining the domestic industry. Article 4 of the Antidumping Agreement states that the domestic industry includes domestic producers of 'like products'. Defining the domestic industry is also a case-by-case determination. If national antidumping authorities define the domestic industry broadly, they may decrease the dumping margin or the likelihood of finding dumping; but, if they use a narrow definition to focus on a particular sector that is hurt, this may allow future circumvention.

The term 'like product' is defined in the Antidumping Agreement to mean 'a product which is identical' or 'has characteristics closely resembling the product under consideration'.[42] Obviously, this is a vague definition that leaves the area largely unsettled. State practice concerning the 'like product' issue varies widely.[43] For example, concerning polyester staple fibres (PSF), the EC antidumping authority consistently holds that all PSF types are one product, while the US antidumping authority divides PSF into different end-use categories.[44] The 'like product' definition in Article 2.6 seems to be designed to allow such variations and to maximize discretion by national antidumping authorities. No WTO Panel has yet considered the issue, but the *Indonesia—Automobiles* case,[45] which involved the SCM Agreement, interpreted 'like product' to mean that similar physical characteristics is one criterion, but that other factors, such as tariff classification principles, whether the products are substitutable, and brand loyalty and reputation, may also be utilized by national antidumping authorities in making the 'like product' determination. If this holding is carried over to antidumping, the discretion of national antidumping authorities on the 'like product' issue would be the beneficiary.

The question arises whether the 'like product' term should be more closely defined in order to limit this discretion and to increase legal certainty. For example, a market-based test could be used, grouping products as 'like' that are in direct competition with each other. This question can be resolved only through future negotiations by WTO members.[46]

2.3.2 Comparison of third-country prices

In two situations, the determination of dumping can be made by comparing the export price with the price of the like product when exported to an 'appropriate third country', provided the third-country price is 'representative'.[47] These situations arise (1) when there are no sales of the like product in the ordinary course of trade in the home country; or (2) where there is a low volume of such sales.[48]

[42] Ibid. Art. 2.6.

[43] Specific examples are collected in Adamantopolous and De Notaris, 'The Future of the WTO and the Reform of the Anti-dumping Agreement', n. 16 at 36–8.

[44] Ibid. 36. [45] Panel report, *Indonesia—Automobiles*, paras. 14.210–14.222.

[46] For a detailed analyais of 'like products' in WTO agreements, see Won-Mog Choi, *'Like Products' in International Trade Law, Toward a Consistent GATT/WTO Jurisprudence* (Oxford University Press, 2002).

[47] Antidumping Agreement Art. 2.2. [48] Ibid.

2.3.3 Constructed value

In some situations, there is no domestic sale of the product in question or, if there is such a sale, the national antidumping authority cannot rely on the sale as the reference of comparison. For example, demand for a product in the domestic market may be so small that producers do not sell it domestically, but only export. It may be that the purchaser specially orders the product and that there cannot be any sale in the domestic market. This situation may happen, for example, if NASA (the US space agency) purchases sophisticated equipment to be installed in a satellite. The details of specifications of this equipment are announced, and suppliers produce this product to meet the requirements of those specifications. Such equipment would be sold only to NASA, and there would be no sale in the domestic market.

If there is no domestic price or the domestic price is not suitable for comparison, national antidumping authorities may compare the export price with the constructed value of the product.[49] The term 'constructed value' means the price of a product that is constructed by adding a reasonable amount of administrative expenses and a profit margin to the cost of the product.[50]

Constructed value is not a price that exists, but is calculated by adding costs, selling, general, and administrative (SG&A) costs, and profit. In calculating 'constructed value,' the amounts for SG&A costs and profit must be based on actual data pertaining to production and sales in the ordinary course of trade of the like product by the exporter or producer under investigation.[51] When such amounts cannot be determined on that basis, they may be determined based on the following:[52]

1. The actual amounts incurred and realized by the exporter or producer under investigation in respect of production and sales in the domestic market of the country of origin of the same general category of products;
2. The weighted average of the actual amounts incurred and realized by other exporters or producers subject to investigation in respect of production and sales of the like product in the domestic market of the country of origin; or
3. Any other reasonable method, provided the amount for profit so established shall not exceed the profit normally realized by other exporters or producers on sales of products of any of the same general category in the domestic market of the country or origin.[53]

When calculating constructed value, national antidumping authorities must use the actual data of the exporter or producer under investigation or, if this is not possible, the actual data of other exporters and producers producing and exporting like products.

In *EC—Bed Linen*, the EU antidumping authority used the constructed value of Indian bed linen and relied on the data of one firm in India that produced and exported like products. There was no other exporter or producer of like products.

[49] GATT Art. VI; Antidumping Agreement Art. 2.2. [50] Antidumping Agreement Art. 2.2.
[51] Ibid. Art 2.2.1.1. [52] Ibid. Art 2.2.2(i), (ii), and (iii). [53] Ibid. Art. 2.2.2.

India objected on the ground that Article 2.2.2(ii) uses the term 'weighted average' to calculate constructed value. The Panel ruled that the wording of Article 2.2.2(ii), 'weighted average', includes the singular and that, therefore, using data from one exporter or producer in the country of origin is permissible. India appealed this ruling to the Appellate Body. The Appellate Body reversed this ruling for the following reasons.

The Appellate Body stated that 'weighted average' in Article 2.2.2(ii) precludes an interpretation that 'other exporters or producers' in the plural can include a singular case. It concluded:

> We disagree with the Panel that the concept of weighted averaging is relevant only when there is information from more than one other producer or exporter available to be considered. We see no justification, textual or otherwise, for concluding that amounts for SG&A and profits are to be determined on the basis of the weighted average some of the time but not all of the time.[54]

2.3.4 Arm's length transactions and transactions between affiliated parties

If an international trade transaction is carried out between two parties that are independent from each other, the agreed upon price can be assumed to reflect the market price. If a transaction is made between affiliated parties, the agreed upon price does not necessarily reflect the market price because the parties can manipulate the price. In the latter situation, national antidumping authorities must disregard the price paid by the affiliated party and use the price at which the product is first sold to an independent purchaser. Article 2.3 of the Antidumping Agreement states:

> where it appears to the authorities concerned that the export price is unreliable because of association or a compensatory arrangement between the exporter and the importer or a third party, the export price may be constructed on the basis of the price at which the imported products are first resold to an independent buyer.

An example is the export of cars from a Japanese manufacturer to its US subsidiary that sells them to independent dealers in the United States. The US antidumping authority

[54] Appellate Body report, *EC—Bed Linen*. The question arises as to whether an interpretation that denies the possibility of calculating the normal value if there is only one other exporter or producer of like products in the country of origin is a reasonable one. This situation is not incomprehensible, and it is a duty of Panels and the Appellate Body to formulate an interpretation that can deal with all situations that may arise. It appears that the interpretation adopted by the Panel that the plural includes the singular makes better sense. Can one not say that Art. 2.2.2(i), (ii), and (iii) provide for representative cases and, as to situations not covered, an inference or analogy should be drawn from this provision?

As an alternative interpretation, one may propose that, while the conclusion of the Appellate Body's ruling is correct, its explanation is insufficient. This view would maintain that a constructed value is an artificial price and, when calculating constructed value, the antidumping authority should endeavour to arrive at a price which approximates market conditions as much as possible. If there is only one exporter or producer of like products in the market of the exporting country, there is insufficient evidence for the antidumping authority to draw an inference as to what the market would be like and to calculate what 'would be SG & A'. According to this interpretation, this is the reason why Art. 2.2.2 (ii) of the Antidumping Agreement does not provide for a situation where there is only one other exporter or producer, and this absence should be interpreted to mean that under this circumstance a constructed value cannot be used.

must compare the price at which cars are sold by the manufacturer to dealers in Japan and the price at which they are sold by the subsidiary to independent dealers in the United States.

2.3.5 Sales below cost

When calculating the value of a product in the domestic market of the exporting country that will be compared with the export price of that product to be exported to the importing country, national antidumping authorities may disregard a sale of the product in the domestic market if such sale is below the cost of production. The rationale for this is that a sale below cost is not a transaction in the normal course of commerce and is not, therefore, appropriate for the standard of comparison. In the 1980s this rule was abused, however, and there were complaints among exporting countries that the rule was itself a trade barrier.

One such complaint was that of the Japanese government in relation to a US Commerce Department investigation of alleged dumping of semiconductor chips. When semiconductor chips were sold, the Commerce Department decided to compare the export price and the 'constructed value' of such semiconductor chips and concluded that there was dumping.

The Japanese government claimed that, in the semiconductor industry, the cost of research and development was so enormous that the initial cost of a semiconductor chip was very high. In the initial period of sale, however, the chips could not be sold if the price were set at the level at which the cost was recovered and a profit was gained, because such a price would not be competitive. Semiconductor producers, therefore, had to set the initial price at a level below the cost of production. Over an extended period, the cost would decline dramatically due to mass production and mass sales. If, therefore, the cost–price ratio were calculated for an extended period, such as six months or one year, there would be no sales at prices below the cost of production. It was claimed that a sufficient period should be taken into consideration when determining whether a domestic price was below the cost of production.

The negotiators in the Uruguay Round thought that it was necessary to address this issue, and the following new rules were incorporated into the Antidumping Agreement:

1. National antidumping authorities may disregard a sale below cost as the standard for comparison if such a sale is made (a) in an extended period, (b) in substantial quantity, and (c) at the price that would make recovery of all the cost in a reasonable period impossible.[55]
2. 'Extended period' normally means one year, and in no case may it be less than six months.[56]
3. 'Substantial quantity' means that the weighted average of the sales price of the product in question is below the weighted average of the cost of producing one

[55] Antidumping Agreement Art. 2.2.1. [56] Ibid. Art 2.2.1., fn. 4.

unit of that product, or that the quantity of sale of the product at the price below cost is no less than 20 per cent of the total sale of the product.[57]

2.3.6 Fair price comparisons

When comparing the normal value and the export price, the former is often denominated in the domestic currency and the latter in a foreign currency. The problem is that the exchange rate between those two currencies fluctuates, and this fluctuation affects the price comparison. Suppose, for example, a Japanese auto company exports a car to the United States; the domestic sales price is ¥2,000,000; and the export price is US$20,000 at the exchange rate of US$1 = ¥100 that prevails when the car is shipped from the factory. The auto company exports the car to its subsidiary in the United States, and the subsidiary sells it to a dealer there. This sale may take place three months later, and the exchange rate may be US$1 = ¥50.

If the price comparison is made when the car is shipped from the factory, there is a parity of prices (¥2,000,000 (domestic price) = US$20,000 (export price)). But if the price comparison is made when the car is sold to a dealer, the export price will still be US$20,0000 but the domestic sales price of ¥2,000,000 will be calculated as US$40,000. There is no dumping in the former situation, but there is dumping in the latter. This is called 'technical dumping'. This hypothetical indicates that, for a fair price comparison, it is important to establish the exchange rate that is used when comparing prices.

In comparison of domestic and export prices, the exchange rates prevailing on the date of sale must be used.[58] The date of sale is defined as the date of contract, date of purchase order, date of order confirmation, or date of invoice.[59] If a dumping margin is created through fluctuations of the exchange rate, exporters are allowed a six-month period in which to make adjustments of domestic and export prices.

One issue in connection with fluctuation of exchange rates is how to deal with a situation in which there is a sharp change in the exchange rate during the period of investigation. For example, if there is a sudden change of exchange rate at the end of the investigation period, the question arises whether national antidumping authorities should take an average of prices in this period or whether it should disregard prices in the period in which, due to a sharp drop of the value of the domestic currency in relation to the currency in which export prices are represented. This question was addressed in a case in which the US antidumping authority imposed antidumping duty on steel imports from Korea in which the US authority divided the period of investigation into two subgroups in order to take into account of a major devaluation of the won. Then the US authority calculated a weighted average margin of dumping for each sub-period and, when combining the two sub-periods to calculate an overall dumping margin, it treated sub-periods where the average export price was higher than the average normal value as a zero in the final overall calculation. The Panel found that this practice was a violation of Article 2.4.2 of the Antidumping Agreement.[60]

[57] Ibid. Art 2.2.1, fn. 5. [58] Ibid. Art. 2.4.1. [59] Ibid. fn. 8.
[60] Panel report, *US—Stainless Steel (Korea)*, 1 February 2001, WT/DS179/R.

2.3.7 Averaging

Another important issue in a fair comparison of domestic and export prices is that of 'averaging'. In the past, antidumping authorities in the United States and the EU utilized the 'averaging' method when comparing domestic and export prices.[61]

The following example illustrates the averaging method. Company A (a Japanese company) sells Product X in the domestic market and exports it to the EU market. In the domestic market, the average price of Product X is equivalent to $100 per unit. Company A exports Product X to the markets of the UK, Germany, France, and Italy. The price at which Product X is exported to the UK is $80; that at which it is exported to Germany is $90; that at which it is exported to France is $110; and that at which it is exported to Italy is $120. Assuming that the volume of sales is the same to each market, the weighted average of export price is equivalent to $100.

If the average prices were compared, there would be no difference between domestic prices and export prices and, therefore, no dumping. In the past, the antidumping authorities of the United States and the EU, however, compared the weighted average of the domestic price with each of the export prices before averaging. If an export price is lower than the average domestic price, that export price is judged to be a dumping price. If, on the other hand, an export price is higher than the average domestic price, that export price is disregarded. There was, therefore, a non-symmetrical comparison between the domestic price and export prices and, consequently, dumping was artificially 'created'. There would be no dumping if there were a symmetrical comparison. The result was that there was dumping in almost all situations where there are a number of sales transactions both in the domestic market and the export market of a product.

To remedy this situation, the Antidumping Agreement provides that, in principle, an antidumping authority should compare either 'a weighted average normal value with a weighted average of prices of all comparable export transactions' or 'normal value and export prices on a transaction-to-transaction basis'.[62] Antidumping authorities may, however, deviate from this rule when there is evidence that exporters manipulate domestic and export prices so that there is no dumping margin if a comparison of prices is made on a weighted average basis.[63]

2.3.8 Zeroing

Zeroing is a variation of the averaging issue. Zeroing refers to a method by which national antidumping authorities count as zero the dumping margin for which the weighted average difference between normal value and the export price is negative. In the *EC—Bed Linen* case,[64] the EC imposed an antidumping duty on imports of cotton-type bed linen from India. In calculating the dumping margin, the EC compared

[61] See 2000 Report on the WTO Consistency of Trade Policies by Major Trading Partners, The Industrial Structure Council, The Ministry of International Trade and Industry (2000) at 53–4.

[62] Antidumping Agreement Art. 2.4.2. [63] Ibid.

[64] Appellate Body report, *EC—Bed Linen*; Panel report, *EC—Bed Linen*. See also Panel report, *US—Stainless Steel (Korea)*, 1 February 2001, WT/DS179/R.

weighted average export prices and the weighted average normal value for each of several models (product types of bed linen). In some cases, the export price was lower than the normal value, and, in others, the export price was higher than the normal value. In each of the latter cases, there was a 'negative' margin of dumping. The EC then calculated a weighted average dumping margin for cotton linen based on the results obtained in the comparisons. The EC calculated the dumping amounts by multiplying the value of the imports of each model by the margin of price difference for each model and counted as zero the dumping amount for those models where the margin was negative. The EC then divided the total dumping amount by the value of the exports involved, counting all negative dumping margins as zero.

In short, the EC computed the dumping margin by comparing a weighted average of export prices and the normal value of each model of the product in question but, when it came to calculating the dumping margin for the totality of the product by averaging the whole of dumping margins, the EC disregarded the 'negative dumping margin' that accrued with respect to some models. This was a device to inflate dumping margin by disregarding the portion of export price which was higher than the normal value (the domestic price) and treating the excess by which export price exceeded the domestic value as zero. Therefore, the dumping margin was calculated to be larger than it would have been if 'negative dumping' had been taken into consideration. India argued that such a 'zeroing' of negative dumping was contrary to Article 2.4.2 of the Antidumping Agreement.

The following hypothetical further illustrates this zeroing practice: Suppose the product in question can be categorized as Product A, Product B, Product C, and Product D. The domestic value of Product A is $115 and the export price is $96. The dumping margin is 20. The domestic value of Product B is $80 and the export price is $70. The dumping margin is 10. The domestic value of Product C is $100 and the export price is $150. The dumping margin is minus 50. The domestic value of Product D is $105 and the export price is $85. The dumping margin is 20. If all of the dumping margins are taken into account and averaged out, the dumping margin would be zero. However, if the minus dumping margin (minus 50) is treated as zero, there would be a dumping margin of 12.5 per cent.

The Panel in the *EC—Bed Linen* case recognized that a dumping margin should be established on the basis of a comparison of a weighted average normal value with a weighted average of prices of all comparable export transactions or on the basis of a comparison of individual transactions, and then noted that Article 2.1 of the Antidumping Agreement states that 'a product is to be considered as being dumped' when that product is imported at less than its normal value. The Panel noted that Article 2.4.2 of the Antidumping Agreement specifies that the weighted average normal value shall be compared with a weighted average of 'all' comparable export transactions. In this case, however, the EC did not compare the prices of all comparable export transactions, but counted as zero the results of comparison showing a negative margin. The Panel ruled that this was an impermissible change of the results of an otherwise proper comparison. The practice of the EC amounted to counting the weighted average export price to be equal to the weighted average normal value for those models for which negative margins were found in the comparison, although it was, in fact, higher

than the weighted average normal value. For these reasons, the panel ruled that the zeroing used by the EC was inconsistent with Article 2.4.2 of the Antidumping Agreement.

This finding of the Panel was upheld by the Appellate Body. The Appellate Body reasoned that, under Article 2.4.2 of the Antidumping Agreement, an administering authority is called upon to determine whether there is dumping with regard to 'a product' but not a type or a model of the product, and it was incumbent on the EC to calculate the dumping margin of the product in question.[65]

In *US—Softwood Lumber*,[66] the United States imposed antidumping duties on softwood lumber imported from Canada. The United States divided the product under investigation into subgroups of identical or broadly similar product types and calculated a weighted average normal value and a weighted average export price per unit within each subgroup. When the normal value was equal to or less than the export price for a subgroup, the dumping margin was calculated as zero. The Appellate Body held that dumping can be found to exist only for the product under investigation as a whole and cannot be found to exit only for a type, model, or category of that product.[67] It also stated that the results of multiple comparisons at the sub-group level through multiple averaging are not margins of dumping within the meaning of Article 2.4.2. of the Antidumping Agreement and no more than intermediate calculations of dumping margin. It held that it is only on the basis of aggregating all these intermediate values that an investigating authority can establish margins of dumping for the product under investigation as a whole.[68] The approach of the Appellate Body in *US—Softwood Lumber* in dealing with the issue of zeroing is quite similar to that in *EC—Bed Linen*.

In *US—Zeroing and Sunset Reviews*,[69] Japan claimed that the use of zeroing in annual reviews violated the Antidumping Agreement. The Panel held that, whereas the use of zeroing in initial investigations was contrary to the Antidumping Agreement, its use in periodical reviews was not. Japan appealed this Panel's finding and the Appellate Body reversed the Panel and ruled that it was contrary to the Antidumping Agreement.

2.3.9 Non-market economy

Antidumping is based on the assumption that exporters and importers operate in a market economy. If an exporter produces and sells products in a non-market economy (such as a socialist economy), antidumping concepts on domestic prices (normal value) do not apply any more. To deal with dumping issues where exporters operate in a non-market economy, GATT Article IV, Annex I, paragraph 1:2 states: 'It is recognized that, in the case of imports from a country which has a complete or substantially complete

[65] *EC—Bed Linen*, paras. 46–58.
[66] *US—Softwood Lumber V*, WT/DS264/AB/R, adopted 31 August 2004.
[67] Ibid. para. 93. [68] Ibid. paras. 95–8.
[69] Panel report, *US—Zeroing and Sunset Reviews*, WT/DS322/R, January 23, 2007; Appellate Body report, WT/DS322/AB/R, 23 January 2007.

monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purposes of paragraph 1 and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate'.

WTO members have tried to cope with this issue by allowing antidumping authorities to disregard domestic prices of the non-market economies and substitute them with prices constructed from data in a surrogate third country. For example, if Country A is regarded as a non-market economy, the domestic prices of that country are disregarded by the antidumping authority of Country B, the importing country. The authority in Country B then uses economic data such as prices and costs of production in Country C (a third country) that is a market economy and constructs the domestic price of Country B. The price constructed in this way is used to calculate the dumping margin of products exported from Country B.

Section 15(a)(ii) and (d) of the China Accession Protocol (Protocol of Accession of China to the WTO) states that, for fifteen years following the accession of China to the WTO (2001–16), WTO members may treat China as a non-market economy and use the above method of calculation when dealing with imports from China. Therefore, China is subject to non-market economy status until 2016.[70]

2.4 Determination of injury

2.4.1 Material injury or threat of material injury

Before imposing an antidumping duty, WTO members must make a determination of material injury or threat thereof to a domestic industry or material retardation of the establishment of a domestic industry.[71] The term 'material injury' is, however, not defined. The Appellate Body has concluded that the 'material injury' standard for antidumping measures is lower than the 'serious injury' standard for safeguard measures.[72] It reasoned that the degree of injury to a domestic industry should be something less for antidumping measures than for safeguard measures because antidumping measures counteract 'unfair' trade whereas safeguard measures counteract 'fair' trade.[73] The terms 'threat' of material injury and 'material retardation' are also not defined.

Determination of material injury to a domestic industry must be based on evidence regarding (1) the quantity of dumped product and its effect on the price of like domestic products; and (2) its effect on producers of such domestic products.[74] With regard to the quantity of dumped import, the national antidumping authority must

[70] For a detailed analysis of the non-market economy status of China, see Yanning Yu, 'Rethinking China's Market Economy Status in Trade Remedy Disputes after 2016: Concerns and Challenges' (March 2013) *Asian Journal of WTO & International Health Law and Policy* 8(1), 77–113.

[71] GATT Art. VI; Antidumping Agreement Art. 3, fn. 9.

[72] Appellate Body report, *US—Lamb Safeguard*, para. 124.

[73] Ibid.; see also Appellate Body report, *Argentina—Footwear Safeguard*, para. 94.

[74] Antidumping Agreement Art. 3.1. For an application, see Panel report, *Egypt—Definitive Antidumping Measures on Steel Rebar from Turkey*, 1 October 2002, WT/DS211/R.

examine whether there is a significant increase in the quantity of dumped product. An increase of import can be absolute (for example, the quantity of import increases) or relative (for example, the quantity of import remains the same as before, but the supply of domestic products is reduced and, consequently, the market share of imports increases). With respect to price, the antidumping authority must investigate whether the dumped product undercuts the like domestic products, depresses the domestic price, or prevents the domestic price from rising.[75]

2.4.2 Factors to be considered when determining injury

In determining whether material injury exists, Article 3.4 requires national antidumping authorities to consider:

> all relevant economic factors and indices having a bearing on the state of the industry, including actual and potential decline in sales, profits, output, market share, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; the magnitude of the margin of dumping; actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments.

The Appellate Body has concluded that national antidumping authorities must evaluate all of the factors listed in Article 3.4 when examining whether there is a material injury due to dumping.[76] The impact of these rulings on national antidumping authorities appears to be that specific findings have to be made with respect to all the factors listed in Article 3.4.

2.4.3 Factors to be considered when determining threat

In determining whether a threat of material injury exists, Article 3.7 requires national antidumping authorities to consider specific factors. One question of interpretation is whether antidumping authorities must consider the impact of the dumped imports on the domestic industry (Article 3.4) as well as the Article 3.7 factors in determining whether a threat of material injury exists. In *Mexico—Corn Syrup (HFCS)*, the Mexican antidumping authority based its finding of a threat of injury on Article 3.7.[77] The United States argued before the Panel that it was wrong for Mexico to rely solely on Article 3.7 in determining a threat of injury, because Article 3.4 is the general provision for finding injury and applies to both injury and the threat of injury. The Panel concluded that national antidumping authorities must also consider the Article 3.4 factors in making a threat of injury determination.[78]

Under Article 3.7, the national antidumping authorities must determine whether, in the absence of protective action, material injury would occur. Thus, consideration of

[75] Antidumping Agreement Art. 3.2.
[76] See, for example, Appellate Body report, *Thailand—H-Beams*, para. 128; Appellate Body report, *EC—Bed Linen*, para. 168; Appellate Body report, *US—Hot-Rolled Steel from Japan*, para. 194.
[77] Panel report, *Mexico—Corn Syrup (HFCS)*, para. 7.131. [78] Ibid. para. 7.32.

the Article 3.4 factors is required in a case involving threat of injury in order to make a determination consistent with the requirements of Article 3.1 and 3.7.

2.4.4 Cumulation of injuries

National antidumping authorities may cumulate injuries when (1) more than one exporting country is involved; and (2) exporters from all of the exporting countries are engaged in dumping.[79] An example of cumulation of injuries is as follows. Product X is dumped into the market of Country A from several countries (B, C, and D). Imports from B and C occupy 90 per cent of the dumped product and those from D share only 10 per cent. Imports from D, standing alone, would not cause a material injury to a domestic industry. The question is whether the antidumping authority of the importing country may cumulate injuries caused by imports from B, C, and D and decide that there is material injury to a domestic industry caused by dumped imports from B, C, and D.

National antidumping authorities may make such a cumulation as long as (1) an import from each country is more than *de minimis*; and (2) a cumulation is appropriate in light of the competitive relationship between imports from those countries and between imported product and domestic product.[80]

2.4.5 Causation

There may be factors other than dumping that cause injury to a domestic industry. Before a WTO member may impose an antidumping duty on imports, a causal link between dumping and injury must be established. Under Article 3.5 of the Antidumping Agreement, national antidumping authorities must take into consideration all of the relevant factors causing material injury to a domestic injury, including those other than dumping (for example, domestic competition, decline of demand, change of consumers' preference, and restrictive business practices) in assessing injury to a domestic industry, and the injury caused by those other factors must not be attributed to the dumped imports.

Article 3.5 of the Antidumping Agreement requires that national antidumping authorities 'shall examine any known factors other than the dumped imports which at the same time are injuring the domestic industry'. In *Thailand—H-Beams*,[81] one of the issues was the meaning of 'any known factors'. Poland, the petitioner, argued that the government applying an antidumping measure must on its own look for any factor other than dumping that may have caused material injury to a domestic industry. The Panel, however, found that the term 'any known factors' includes only causal factors that are raised before the national antidumping authorities by interested parties in the course of an investigation. It is not, therefore, incumbent on national antidumping authorities to 'seek out and examine' in each case on their own initiative the effects of

[79] Antidumping Agreement Art. 3.3. [80] Ibid. [81] Panel report, *Thailand—H-Beams*.

all possible factors other than imports that may be causing injury to the domestic industry.

In *Thailand—H-Beams*,[82] another issue was whether national antidumping authorities can base their determination on confidential evidence not disclosed to the parties. The Appellate Body ruled that national antidumping authorities are not required to base an injury determination only on evidence disclosed to or discernible by the parties to the investigation. It considered that an antidumping investigation involves the commercial behaviour of firms and involves the collection and assessment of both confidential and non-confidential information. The Appellate Body concluded that an injury determination must be based on the totality of evidence and that nothing in Article 3.1 of the Antidumping Agreement requires national antidumping authorities to base an injury determination only on non-confidential information.[83]

The antidumping agreement concluded in the Kennedy Round of trade negotiations in 1967 contained a provision that stated that, in determining the causation between a dumping and an injury, there should be evidence to show that the dumping was demonstrably the major cause of the injury. This provision, however, was regarded as too strict and, when the Tokyo Round concluded in 1979, a provision in a new antidumping agreement stated that injuries caused by factors other than dumping should not be attributed to the dumping. Article 3.4 of the Antidumping Agreement adopted wording that is essentially the same as in the Tokyo Round antidumping agreement.

2.5 Domestic industry

An antidumping duty is imposed when there is a dumping that causes a material injury to a domestic industry and causation is shown between the dumping and injury. The meaning of a domestic industry is defined as:

> the domestic producers as a whole of the like products or . . . those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products.[84]

If a domestic producer is related to or affiliated with exporters or importers of the product in question or the domestic producer is an importer of the product, national antidumping authorities may decide that such a domestic producer should be excluded from the category of domestic industry. This is because a domestic producer that is related to exporters or importers of the dumped product or is itself an importer of that product and, thereby, presumably benefits from such relationship does not need protection by an antidumping measure. The term 'related' rather than 'affiliated' is used in the Antidumping Agreement. Domestic producers will be considered to be

[82] Appellate Body report, *Thailand—H-Beams*.

[83] A question, however, arises under this ruling as to whether the rights of parties to an antidumping proceeding can be properly protected. If national antidumping authorities are authorized to base their determinations on undisclosed evidence, how can parties present their views on the evidence and, if necessary, produce counter-evidence?

[84] Antidumping Agreement Art. 4.1.

'related' to exporters or importers if: (1) a domestic producer directly or indirectly controls an exporter or vice versa; (2) both are directly or indirectly controlled by a third person; and (3) it is likely that the domestic producer acts differently from the way it would if there were no such relationship.[85]

In *US—Hot-Rolled Steel*,[86] the Appellate Body dealt with the question of whether or not production of hot-rolled steel by the domestic industry for 'in-house consumption' can be excluded from the scope of domestic industry. The Appellate Body ruled that an injury determination must be based on the totality of the domestic industry and not simply on one part of the domestic industry.[87]

2.6 The imposition of antidumping measures

2.6.1 Provisional measures

After an antidumping investigation is initiated, imports of the products under investigation may suddenly increase in anticipation of the imposition of an antidumping duty. Such a sudden increase in imports may cause damage to a domestic industry. When such an increase is likely to occur, national antidumping authorities may impose a provisional measure. Article 7 of the Antidumping Agreement regulates the imposition of provisional measures by national antidumping authorities. National antidumping authorities may apply provisional measures only after making a preliminary affirmative determination of dumping and determining that provisional measures are necessary to prevent damage that may occur during the period of investigation. In general, provisional measures may be applied for no more than four months. Provisional measures may be applied for six months, however, if so requested by exporters that account for a substantial portion of the transactions in question.[88]

2.6.2 Definitive measures

The maximum amount of antidumping duty is the difference between the domestic price and the export price. If a duty less than this can effectively eliminate the harm of dumping to a domestic industry, a lesser duty is regarded as desirable.[89] Under the Antidumping Agreement, the lesser duty rule is hortatory rather than mandatory.

The following hypothetical example illustrates the lesser duty rule. The normal value (domestic price) of Commodity X in Country Y is $150 and its export price to Country Z is $100. Therefore, the dumping margin is 50. The price of the domestic industry in Country Z producing and selling a like product (competing product) in the domestic market of Country Z is $120. In this situation, if the antidumping authority of Country Z imposes on imports of Commodity X from Country Y an antidumping duty equal to

[85] Ibid. Art 4.1(i), fn. 11. [86] Appellate Body report, *US—Hot-Rolled Steel*.

[87] It seems, however, that this ruling is valid only on the premise that there is cross-elasticity of demand between the captive market and the merchant market, i.e. there is a condition that the product in question flows into the captive market if the cost of production there becomes high. As long as the product can shift back and forth between the captive market and the merchant market, both markets can be regarded as an integrated market.

[88] Antidumping Agreement Art. 7.4. [89] Ibid. Art. 9.

$20, the price of dumped Commodity X in the market of Country Z is $120 ($100þ $20¼$120) and the parity of the export price and the domestic price is restored. In this approach, the antidumping authority imposes an antidumping duty equal to 'injury margin' and, for this reason, it can be called the injury margin rule.

2.6.3 Retroactivity

As a general rule, antidumping duties cannot be imposed retroactively, but may be applied only after all requirements for the imposition of antidumping duties have been fulfilled.[90] However, where a final determination of injury (but not threat or material retardation) is made, duties may be applied retroactively to the date of provisional measures.[91] Where a final determination is negative, any cash and bonds deposited must be refunded.[92]

2.6.4 Duration and review

An antidumping duty shall remain in force only so long as and to the extent necessary to counteract the dumping that is causing injury.[93] This determination of 'necessary' is made in conjunction with a finding of whether the continued imposition of the duty is needed to offset dumping and whether the dumping and the injury would be 'likely to recur' if the duty were removed.[94] There is also an obligation to review the need for continued antidumping duties after 'a reasonable period of time'.[95]

Under a general 'sunset' clause[96] in the Antidumping Agreement, antidumping duties must be terminated in any event on a date not later than five years after their imposition or after the date of their most recent review unless it is determined that the expiry of the duty would be likely to lead to a continuation or recurrence of dumping and injury.[97]

2.7 Price undertakings (suspension of antidumping duty investigations)

Antidumping investigations are costly and burdensome to exporters, importers, and national antidumping authorities. Settlements between exporters and national anti-dumping authorities can save time and resources. For this reason, the Antidumping Agreement permits a 'price undertaking', whereby an exporter subject to an anti-dumping investigation offers a price undertaking to the national antidumping authority to the effect that there would be an increase of export price to eliminate the dumping margin or otherwise cease the alleged dumping.[98] If the antidumping authority accepts this offer, the investigation is suspended. National antidumping authorities may accept a price undertaking only after making an affirmative preliminary determination of dumping and injury caused by such dumping.[99] The party

[90] Ibid. Art. 10.1 and 10.4. [91] Ibid. Art. 10.2. [92] Ibid. Art. 10.5.
[93] Ibid. Art. 11.1. [94] Ibid. Art. 11.2. Appellate Body report, *US—DRAMS*, paras. 751–2.
[95] Antidumping Agreement Art. 11.2. [96] Ibid. Art. 11.3. [97] Ibid.
[98] Ibid. Art. 8. [99] Antidumping Agreement Art. 8.2.

requesting a price undertaking may request that the dumping and injury investigation be continued.[100] If the antidumping authority determines that there is neither injury nor threat thereof, the price undertaking will have no effect.[101] If there is a violation of the terms of the price undertaking, the antidumping authority may resume the investigation.[102]

2.8 Anti-circumvention

'Anti-circumvention' measures aim at preventing foreign producers or exporters subject to an antidumping duty from circumventing that duty. For example, a company subject to an antidumping duty order in country A might decide to establish a factory in country A and assemble the same product from imported parts and components. Another example of circumvention is that a company subject to antidumping may shift production to one or more third countries.

Thus, exporters may try to avoid paying antidumping duties by shifting their sites of production or exporting the product from different countries. The question is whether the country that imposed the antidumping duty on imports is justified in taking measures to counter such a move.

On the one hand, the importing country may be justified in imposing anti-circumvention measures because circumvention nullifies or reduces the effectiveness of antidumping duty. On the other hand, circumvention actions are nothing more than direct investment in the importing country or a third country. Direct investment helps the local economy by creating employment and paying local taxes. One may argue that such a move on the part of an exporter is a legitimate business action.

The WTO Antidumping Agreement does not speak to circumvention because there was no agreement on this issue in the Uruguay Round. Some countries, such as the United States and the European Union, enforce anti-circumvention measures; others, such as Japan, do not.

Only one pre-WTO case dealt with the issue. In 1990, a GATT Panel[103] considered a case in which the EC had imposed an antidumping duty on imported parts and components that were used to assemble a product in a factory in the EC. The EC found that there was little value added in the EC assembly operation and that the scheme was a circumvention of antidumping duties previously imposed on the importer. The GATT Panel disagreed, ruling that the EC measure was a discriminatory internal tax imposed on foreign-made components contrary to the national treatment obligation of GATT Article III:2.

The legality of anti-circumvention measures under the GATT and the Antidumping Agreement is uncertain. The Committee on Antidumping Practices has examined the issue, but no agreement has been reached yet. This is an important issue, and an early resolution is desirable.

[100] Ibid. Art 8.4. [101] Ibid. [102] Ibid. Art. 8.6.

[103] *EEC—Regulation of Imports of Parts and Components*, 16 May 1990, GATT B.I.S.D. (37th Supp) at 132 (1990).

2.9 Dispute settlement

Any WTO member that believes that a benefit accruing to it under the Antidumping Agreement or that the achievement of any objective of the Agreement is being impeded can refer the matter to the WTO's Dispute Settlement Body (DSB). The DSB will establish a Panel to hear the case if a satisfactory solution cannot be reached through consultations with the parties.[104] A threshold question is whether WTO review is proper. In *Guatemala—Cement*, the Appellate Body concluded that it lacked jurisdiction to review Mexico's claim that Guatemala had violated the Antidumping Agreement. Interpreting Article 17.4 of the Antidumping Agreement, the Appellate Body ruled that it had jurisdiction to review only (1) a definitive antidumping duty; (2) a price undertaking; or (3) a provisional measure. Mexico's request for review focused on actions taken by Guatemala during the course of the antidumping investigation.

Article 17.6 provides for a standard of review in WTO antidumping cases:

(i) in its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned;

(ii) the panel shall interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of public international law. Where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.

Subsection (i) of this provision articulates a standard of deference to national antidumping authorities regarding review of the facts of an antidumping case.[105] Subsection (ii) is properly less deferential when it comes to review of the law. International standards under the Antidumping Agreement should prevail over inconsistent national laws. Under subsection (ii), the Agreement is to be interpreted according to the norms of customary international law; this can be taken to refer to the Vienna Convention on the Law of Treaties (VCLT),[106] which codifies those norms. Article 31 of the Vienna Convention requires that a treaty be interpreted in accordance with 'the ordinary meaning [of the] terms of the treaty in their context and in the light of its object and purpose'. Article 32 of the Convention allows recourse to supplementary

[104] A 1988 GATT Panel decision (unadopted) on the US application of antidumping duties on imports of Swedish stainless steel pipe and tube products became a cause célèbre for US negotiations at the Uruguay Round seeking to negotiate a standard of review in dumping cases that would be deferential to national authorities. See Minutes of Meeting held on 24, 25, and 26 October 1988, GATT Doc. ADP/M/24 9, 9 January 1989. What resulted was a standard of review that says that if analysis under international law norms produces ambiguity, the national antidumping authority's interpretation prevails.

[105] Antidumping Agreement Art. 17.

[106] U.N. Doc. A/Conf. 39/27, 23 May 1969, available at <http://www.un.org/law/ilc/texts/treatfra.htm>. See generally Steven P. Crowly and John H. Jackson, 'WTO Procedures, Standard of Review, and Deference to National Governments' (1996) *Am. J. Int'l L.* 90, 193.

means of interpretation, such as preparatory work of the relevant agreement where the ordinary meaning is obscure or ambiguous.

The premise of Article 17.6(ii) is that there can be at least two permissible interpretations of a provision of the Antidumping Agreement. Panels, however, are required to interpret provisions of any WTO agreement according to Articles 31 and 32 of the Vienna Convention. Article 17.6 of the Antidumping Agreement, however, requires deference to national antidumping authorities in such a case, which is a derogation from the Vienna Convention rule. Thus, Article 17.6(ii) contains an inherent contradiction.

Article 11 of the Dispute Settlement Understanding (DSU) states that Panels shall engage in objective assessments of facts of the matter. In the *US—Hot-Rolled Steel* case,[107] the Appellate Body stated that Article 17.6 of the Antidumping Agreement and Article 11 complement each other. On the other hand, DSU Article 13 confers broad authority on Panels to request information from the parties as well as from third persons. This authority seems to be at odds with Article 17.6(i) and (ii) of the Antidumping Agreement, which restrict the power of Panels with regard to fact-finding. If there is a conflict between DSU Article 13 and Article 17.6 of the Antidumping Agreement, Article 17.6 should prevail as it is particular to the Antidumping Agreement compared with the more general rules of the DSU.

Article 17.6 states a deference principle in fact-finding and legal interpretation of the Antidumping Agreement that Panels should observe when examining a national antidumping authority's disposition of antidumping cases. The intent is to circumscribe the discretion of Panels in reviewing establishment of facts and legal interpretations by the national antidumping authority. Panels must still decide, however, whether the establishment of facts by the antidumping authority is 'proper, unbiased and objective'.[108]

3. Criminal Penalties and Private Remedies

Typically, antidumping legislation authorizes the government of a country to counteract dumping. National antidumping legislation of WTO members must conform to the requirements of GATT 1994 Article VI and the Antidumping Agreement. In the United States, however, the US Antidumping Act of 1916 provided for criminal penalties and private treble damage actions when a dumping causes injury to a domestic industry. Moreover, competition laws provide for the control of predatory pricing and price discrimination that may involve dumping. Should WTO rules apply to these laws?

3.1 The US 1916 Antidumping Act

The 1916 Act provided for (1) criminal penalties and (2) private damage actions brought by private parties. It stated that it was unlawful for any person importing

[107] See Appellate Body report, *US—Hot-Rolled Steel from Japan*.

[108] For an analysis of the issues surrounding standard of review in antidumping, see C. D. Ehlermann and N. Lockhart, 'Standard of Review in WTO Law' (2004) *JIEL* 7(3), 491–521.

any articles to do so at a price substantially less than the actual market value of such articles in the markets of the country of their production if done with the intent of destroying or injuring an industry in the United States. It also stated that any person who violated this provision was guilty of a misdemeanour and could be subject to a fine of up to $5,000 or imprisoned for up to one year. With regard to private remedies, it stated that any person injured could sue in a US court and recover threefold the damages sustained and costs.

In 1999, the EC and Japan brought petitions to the WTO on the ground that the very existence of the Act was contrary to GATT 1994 Article VI and the Antidumping Agreement. The Panel held that the Act was inconsistent with the requirements of both GATT Article VI and the Antidumping Agreement.[109] The United States appealed to the Appellate Body. The EC and Japan cross-appealed on other grounds. The Appellate Body upheld the rulings of the Panel.[110] Two principal issues were considered: (1) whether the US Antidumping Act of 1916 comes within the scope of GATT Article VI and the Antidumping Agreement; and (2) whether the US Antidumping Act of 1916 is discretionary legislation that, unless applied, cannot infringe GATT Article VI or the Antidumping Agreement.

As to the first issue, the Appellate Body stated that, according to GATT Article VI:2, there is dumping when a product of one country is introduced to another at a price below that at which the same or like product is sold in the domestic market of the exporting country and a domestic industry of the importing country is materially injured by reason of the dumping. It held that 'any' measure dealing with dumping as defined in Article VI:2 is covered by this definition.

The Appellate Body interpreted Article 1 of the Antidumping Agreement to provide that an antidumping measure could only be applied under the conditions stipulated in Article VI and only in accordance with the procedure established in the Antidumping Agreement. It stated that Article 18.1 of the Antidumping Agreement makes antidumping duties the only antidumping remedy permitted under WTO law. Thus, the US Antidumping Act of 1916, which provided for criminal penalties and damages, was inconsistent with GATT Article VI and the Antidumping Agreement.

With regard to the distinction between 'mandatory legislation' and 'discretionary legislation', the Appellate Body stated that the 1916 Act does not fall within the category of 'discretionary legislation'. In upholding the ruling of the Panel on this issue, the Appellate Body held that 'the discretion enjoyed by the United States Department of Justice is not discretion of such a nature or of such breadth as to transform the 1916 Act into discretionary legislation'.[111]

The 1916 Act covered not only a situation where a low-priced import injured a national market, but also one in which trade was restrained and monopolized by that import. There is no language in Article VI and the Antidumping Agreement suggesting coverage of 'restraints of trade' and 'monopolization'. The Appellate Body chose to ignore this part of the 1916 Act. It relied on some of the wording in the 1916 Act being

[109] Panel report, *US—Antidumping Act of 1916*.
[110] Appellate Body report, *US—Anti-Dumping Act of 1916.*
[111] Appellate Body report, *US—Antidumping Act of 1916*, paras. 90–1.

similar to language in Article VI and the Antidumping Agreement but ignored its uniquely antitrust language.

In 2004, the United States abolished the 1916 Antidumping Act. However, this amendment did not apply retroactively to cases which had been brought up before the amendment. Therefore, such cases remained unaffected. There were several cases pending in United States courts in which US plaintiffs sought the recovery of damages that they allegedly have sustained due to dumping of Japanese companies.[112] All of these cases except for one were resolved by settlement. In one of these cases, *Goss v Tokyo Kikai Seisakusho Ltd*,[113] the jury awarded treble damages to the plaintiff. The defendant, Tokyo Kikai Seisakusho Ltd, appealed to the Sixth Circuit Court of Appeals but the appellate court upheld the verdict of the district court.[114] The US Supreme Court denied a *writ of certiorari*.[115]

Meanwhile both the EC and Japan respectively enacted clawback statutes[116] which enable domestic enterprises, which had to pay treble damages in the United States under the 1916 Antidumping Act, to bring a suit in their domestic jurisdictions to recover from the US plaintiff the amount paid according to US court orders plus litigation and attorney's fees.

When the US Supreme Court denied a *writ of certiorari*, as mentioned above, Tokyo Kikai Saisakusho, Ltd, notified Goss that it would bring a suit in Japan against Goss on the basis of the Japanese clawback statute to recover the amount that it paid to Goss in pursuance of the US court order under the 1916 Act.

Thereupon Goss brought an action in the US District Court for the District of Iowa for a preliminary injunction restraining Tokyo Kikai Seisakusho, Ltd from bringing a suit in Japan based on the Japanese clawback statute. This action for injunction was approved by the US court on the ground that a Japanese court order granting Tokyo Kikai Seisakusho, Ltd a recovery of the loss incurred due to the payment order of the US Court, would amount to an infringement of the US judicial power.[117] Tokyo Kikai Seisakusho, Ltd, appealed against the injunction to the Court of Appeals for the Sixth Circuit and the appellate court reversed the decision of the district court on the ground that the international comity is important.[118] The US Supreme Court denied a *writ of certiorari* applied for by Goss and the suit against Goss in Japan for the recovery of the amount was settled and the result was not reported. The dispute between Goss and Tokyo Kikai Seisakusho, Ltd, and the subsequent jurisdictional conflict between US

[112] See 'Yamaha, Honda, Suzuki Among Japanese Firms Sued Under 1916 Act' (2006) *Inside U. S. Trade* 22(50), 4.

[113] *Goss Int'l Corp. v Tokyo Kikai Seisakusho, Ltd*, 294 F. Supp. 2d 1029 (N.D. Iowa 2003).

[114] *Tokyo Kikai Seisakusho, Ltd v Goss Int'l Corp.*, 2006 WL 155253 (8th Cir. (Iowa), 23 January 2006).

[115] *Tokyo Kikai Seisakusho, Ltd v Goss Int'l Corp.*, 126 S. Ct. 2363, 5 June 2006.

[116] On the clawback statute enacted by the EC, see Council Regulation (EC) No. 2238/2003 of 15 December 2003, Official Journal of the European Union, L333/1, 20.12.2003. On the Japanese legislation, see Mitsuo Matsushita and Aya Iino, 'Blocking Statute Against the United States 1916 Act (Beikoku 1916 Nen Anchidanpingu Ho nitaisuru Taiko Rippo)' *Boeki to Kanzei (Trade and Tariffs)*, Vol. 625 (1 April 2005), 31–41 and Vol. 626 (10 May 2005), 27–36.

[117] *Goss International Corp. v Tokyo Kikai Seisakusho, Ltd*, 435 F. Supp. 2d 919, (U.S.D.C., N.D. Iowa, 15 June 2006).

[118] *Goss International Corporation v Man Roland Druckmaschienen Aktiengesellschaft, Tokyo Kikai Seisakusho, Ltd, and Mitsubishi Heavy Industries*, 491 _F. 3d 355(8th Cir. (Iowa) 2007, 18 June 2007).

and Japanese courts show that the 1916 Act had an impact that was more far-reaching than the Panel and the Appellate Body anticipated.

3.2 Future implications of the Panel and the Appellate Body report on the *1916 Act* case

Although the 1916 Act was abolished, the rulings of the Panel and Appellate Body reports will have wide implications with respect to legislation of trading nations which deal with price discrimination. The Appellate Body report states that the 1916 Act is legislation covered by Article VI and the Antidumping Agreement for the reason that the 1916 Act deals with the control of differentiated pricing of a product between the domestic market and a foreign market, that is, charging a higher price for a product domestically and a lower price when the same or like product is exported to another country, and this is within the scope of coverage envisaged by GATT 1994 Article VI.

Many WTO members have competition law of one kind or another, including the United States, the European Communities, Canada, Japan, and Members of the European Union. In each body of competition law, there are provisions for the control of price discrimination. The question arises whether, under the ruling of the Panel and the Appellate Body in the *1916 Act* case, all such domestic legislation is amenable to challenge under GATT Article VI and the Antidumping Agreement. To state that all such legislation must meet the requirements of GATT Article VI and the Antidumping Agreement (especially Article 17.4), and a private remedy (collection of damages sustained by a private party due to an international price discrimination or predatory pricing) is not permitted simply because it is not provided for in GATT 1994 Article VI and the Antidumping Agreement seems to create a vacuum in the sense that a private party which suffers from international price discrimination is left without a remedy.[119]

3.3 The US Offset Act

In 2000, the US Congress enacted the Continued Dumping and Subsidy Offset Act which allows collected antidumping and countervailing duties to be distributed to domestic antidumping and subsidy complainants at their requests. This amendment is called the Byrd Amendment. The European Communities and Japan filed a petition with the WTO against the Byrd Amendment and the Panel held that the Byrd Amendment was inconsistent with Article 18.1 of the Antidumping Agreement and Article 32.1 of the SCM Agreement. Upon an appeal by the United States, the Appellate Body reviewed the findings of the Panel and held as follows.[120]

The Appellate Body stated that one of the two issues involved in this case is the meaning of a 'specific action against dumping'. Only if there is a specific action against

[119] In a case in which the nature of the 1916 Act was at issue, a US court held that the 1916 Act was designed to supplement the Clayton Act, s. 2 which prohibits price discrimination and is part of US antitrust laws. See *In re Japanese Electronics Products Antitrust Litigation*, 494 F. Supp. 1190 (E.D. Pa. 1980).

[120] *US—Continued Dumping and Subsidy Offset Act of 2000*, report of the Appellate Body, WT/DS217.234/AB/R, 27 January 2003.

dumping, will it come under the discipline of GATT Article VI and Article 18.1 of the Antidumping Agreement. The Appellate Body stated that specific action against dumping of exports must, as a minimum, encompass action that may be taken only when the constituent elements of dumping are present and that the Panel was correct in finding that the Offset Act is a specific action related to dumping or a subsidy within the meaning of Article 18.1 of the Antidumping Agreement because it is clear from the text of the Offset Act that the offset payments are inextricably linked to, and strongly correlated with, a determination of dumping.[121]

Another issue was the meaning of 'against' dumping. The United States argued that 'against' should mean 'of motion or action in opposition' and in hostility or active opposition to. The Appellate Body stated that the crucial issue is whether or not the design and structure of a measure is such that the measure is opposed to, has an adverse bearing on, or, more specifically, has the effect of dissuading the practice of dumping or the practice.[122]

The Appellate Body noted that the Offset Act effects a transfer of financial resources from the producers/exporters of dumped goods to their domestic competitors, inter alia, in the following ways: (1) the offset payments are financed from antidumping duties paid by the foreign producers/exporters and (2) the offset payments are made to an affected domestic producer defined in the Antidumping Act of 1921 as petitioner or interested party in support of the petition with respect to which an antidumping duty order, a finding under the Antidumping Act of 1921 has been entered, and that remains in operation.[123]

It is to be noted, however, that measures under the Offset Act do not directly intervene into the course of trade in which dumping occurs. It is an *ex post facto* remedy given to domestic petitioners after the antidumping investigation was finished and antidumping duties have been collected. Whether the ordinary meaning of 'against' can be stretched to cover *ex post facto* distribution of antidumping duties is not entirely clear.

4. Conclusions

Antidumping is defined as a measure to counteract dumping, which is a type of 'unfair export'. Dumping, as defined in GATT Article VI and the Antidumping Agreement, however, can include conduct involving only price differences, and not all such conduct is unfair. Dumping is so broadly defined in Article VI and the Antidumping Agreement that conduct that is normal behaviour may be regarded as dumping. It may be rational behaviour for an enterprise to set a high price in the domestic market if the elasticity of demand for a product is small, and to set a lower price in an export market where elasticity is greater. Moreover, sales below cost may occur during a recession when the market price of a product is below the cost of production.

Of course, there are times when sales below cost or price discrimination can be regarded as predatory. As noted above, a predatory dumper could use dumping to drive

[121] Ibid. paras. 238–9, 240–2. [122] Ibid. paras. 253–4. [123] Ibid. paras. 254–6.

competitors out of the market in anticipation of raising prices later and reaping monopoly profits.

One might argue that antidumping should be replaced by measures developed in competition law, such as the control of predatory pricing. In the long run, this should be the goal.[124] In the short term, however, we must live with differences of market conditions and of competition policies among trading nations. There are many imperfections in both national and international markets. Politically, the constituency for antidumping is different from that for competition law. Accordingly, a proposal that antidumping be abolished is probably not possible.

In light of this situation, we propose that the Antidumping Agreement be amended to incorporate concepts that have developed in competition law. Several ideas are given below.

1. To offset or prevent dumping, national antidumping authorities may levy on any dumped product an antidumping duty not greater in amount than the margin of dumping in respect of such product.[125] Therefore, the maximum amount of antidumping duty should be equal to the injury margin. Article 9.1 of the Antidumping Agreement states: 'It is desirable . . . that the duty be less than the margin if such lesser duty would be adequate to remove the injury to the domestic industry'. In addition, Article 3.4 of the Antidumping Agreement lists factors to be examined when determining injury to a domestic industry, which include 'the magnitude of the dumping margin'. The spirit of this provision is that an antidumping duty should be less than the antidumping margin if such a lesser duty accomplishes the purpose of removing the injury to the domestic industry. The language, however, is exhortative rather than mandatory. It is recommended that this lesser duty rule be made mandatory.

The lesser duty rule would allow the collection of an antidumping duty that is equal to the 'injury margin'. In fact, the lesser duty rule is the practice of the European Communities when it enforces its antidumping rule. An example of the lesser duty rule would be as follows: Suppose the domestic value of a product is $100 per unit, the export price of this product is $50, and the domestic price of the competing industry in the country of importation is $70. In this case, the injury margin is $20. If an antidumping duty equal to $20 is imposed, then the difference between the dumped price and the domestic price of the competing domestic industry in the country of importation is removed, and parity is established.

The principle of the lesser duty rule is akin to the 'meeting competition' defence in US antitrust laws.[126] The meeting competition defence permits an enterprise to set a lower price in an area where there is competition than the price the enterprise sets in

[124] See Bernard M. Hoekman and Petros C. Mavroidis, 'Dumping, Antidumping and Antitrust' (1996) *Journal of World Trade* 30, 27.

[125] GATT Art. VI:2.

[126] See *FTC v A. C. Staley Mfg. Co.*, 324 U.S. 746 (1945); *Standard Oil Co. v Brown*, 238 F.2d 54 (5th Cir. 1956); *FTC v National Lead Co.*, 352 U.S. 419 (1957); *In re Minneapolis-Honeywell Regulator Co.*, 44 F.T. C. 351 (1948); *FTC v Standard Oil Co.*, 355 U.S. 396 (1958); *Standard Oil Co. v FTC*, 340 U.S. 231 (1951); *Sunshine Biscuit, Inc. v FTC*, 306 F.2d 48 (7th Cir. 1962); *Balian Ice Cream Co. v Arden Farms Co.*, 104 F. Supp. 796 (S.D. Cal. 1952).

other areas, provided the low price does not undercut the price of competitors. The meeting competition defence thus authorizes an enterprise to set a lower price in an area where there are competitors so that its price matches those of competitors. If the lesser duty rule is applied, and the antidumping duty collected is equal to the injury margin, the price of the dumped product in the market of the importing country would be equal to that of the domestic industry, and the result would be similar to the meeting competition situation.

2. There is no provision in GATT Article VI or the Antidumping Agreement for a public interest requirement, that is, a requirement that national antidumping authorities consider whether the imposition of antidumping duty serves the public interest. ‘Public interest’ in this context would involve a multitude of factors, such as the interests of domestic producers that are affected by dumped imports, importers of the product, and domestic consumers. Article VI and the Antidumping Agreement protect only one interest, namely that of domestic producers. The imposition of an antidumping duty may, however, have a far-reaching effect on other interests in society, such as consumers of the product subject to the antidumping duty. In light of this, it seems reasonable to argue that there should be a provision in Article VI or in the Antidumping Agreement that domestic antidumping legislation contain the requirement that the public interest be considered when deciding whether to impose an antidumping duty.

3. Antidumping duties may have the effect of stifling competition in the importing country. Indeed, a market-dominating enterprise in the importing country may utilize antidumping measures to ward off competition from abroad. Members of a cartel may likewise use antidumping to prevent the cartel from being undermined by competition from abroad. In any event, the imposition of antidumping duties may implicate competition policy. There should be a mechanism through which national antidumping authorities and competition authorities consult with respect to an antidumping measure. In the past, the US competition authorities have engaged in ‘competition advocacy’ before trade authorities. Although this advocacy seems to have had little effect, it seems that the time has come to consider a bridge between national antidumping authorities and competition authorities, now that the introduction of competition policy into the framework of the WTO is being discussed.

4. Advocates of antidumping legislation often argue that antidumping measures are necessary to counteract unfair exports from a country in which the domestic market is closed. There is an element of plausibility to the argument that, if the domestic market is closed to foreign imports through governmental barriers or private anti-competitive practices, the exporters in question possess market power in the domestic market of the exporting country, and they may use monopoly profits to cross-subsidize lower export prices to the market of the importing country. Such export behaviour is indeed unfair.

A logical consequence of the latter argument would be that GATT 1994 Article VI or the Antidumping Agreement should require that national antidumping authorities find that the market of the exporting country is relatively closed to imports before determining that an antidumping duty should be imposed. This requirement seems necessary to establish that the export of dumped product is ‘unfair’. However, who should decide whether a market of the exporting country is closed—the antidumping

authority of the importing country or the competition authority of the exporting country? What if there is no competition authority in the other exporting country? Difficult questions arise in this situation. In any case, there should be close communication and cooperation between competition authorities and antidumping authorities of both exporting and importing countries.

12

Safeguards

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1. Introduction

In the broadest terms, safeguards and safeguard measures refer to the right of a WTO member to impose temporary tariffs, quotas, tariff rate quotas, or other measures to ensure that its economy or domestic industries do not suffer serious harm from imports and trade concessions.

Unlike rights to impose import restrictions to counteract dumping and subsidies, safeguard remedies are not based on any concept of unfair trade or remedy for distortions by exporters. Safeguard remedies allow fairly traded imports to be restricted.[1] Thus, safeguards are a case in which WTO rules allow the introduction of trade distortions and protective measures.

[1] Appellate Body report, *US—Line Pipe*, para. 80 (noting that safeguard measures 'are remedies that are imposed in the form of import restrictions in the absence of any allegation of an unfair trade practice').

There are several reasons for allowing safeguards to operate in a system that emphasizes free trade values. First, safeguard measures are a concession to political realities and the fact that political economy is more than just economics. Trade may improve welfare as a whole, but it does not guarantee prosperity for all. Those hurt by trade may, from a public choice perspective, be very powerful politically. Economic considerations may mean that adjustment assistance in the form of jobsearch help, retraining, and temporary financial assistance to allow trade-displaced workers to move to more productive economic sectors may be the most efficient way of accommodating increased trade, but adjustment assistance is often hard to sell politically.

Second, safeguard measures are often considered a political safety valve so that national policy makers will not hesitate to pursue a long-term free trade strategy.

Third, safeguards are sometimes considered just compensation for workers and firms that suffer from trade liberalization. This theory holds that domestic businesses and workers that suffer a trade-related injury have a just claim against the government for compensation.

Fourth, a rationale for safeguards is to provide a 'breathing space' to firms and policy makers so they can take the action necessary on a macro- or micro-economic level either to restore competitiveness and efficiency to the industry or to undertake an orderly contraction.

Perhaps all of these theories together make up the background for safeguard measures.

2. The Legal and Policy Framework for Safeguards in the GATT/WTO Regime

The GATT/WTO regime establishes two general safeguards provisions as well as methods of invoking safeguards in various economic sectors under specialized agreements involving textiles, agriculture,[2] and services.[3]

The principal safeguards provision is GATT 1994 Article XIX as supplemented by the Agreement on Safeguards, which was approved at the conclusion of the Uruguay Round.

The GATT 1994 also contains provisions in Articles XII and XVIII, Section B, allowing the adoption of import restrictions for balance of payments reasons. These provisions are of diminished importance today because of floating currency exchange rates.

3. GATT Article XIX and the Agreement on Safeguards

3.1 GATT Article XIX

GATT Article XIX is the so-called escape clause because it allows WTO members[4] to escape from their WTO obligations by imposing safeguard measures if the following

[2] The Agreement on Agriculture (Art. 5) permits WTO members to impose special safeguards—in the form of additional duties—on an agricultural product that the WTO member has subjected to 'tariffication'. This matter is discussed in Chapter 6.

[3] General Agreement on Trade in Services (GATS) Art. X.

[4] Art. 2.1, fn. 1 of the Agreement on Safeguards allows a customs union to apply a safeguard measure as a single unit or on behalf of a member state.

three basic requirements are met. First, there must be an increase of imports of the product in question. Second, the increase of imports must be caused by developments that were not foreseen and must result from obligations that the country applying the safeguard measure must respect under the GATT. Finally, the increase of imports must cause or threaten to cause 'serious injury' to a domestic industry producing a 'like' or 'directly competitive' product. These requirements are set forth in GATT Article XIX:1 (a), which reads as follows:

> If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession.

3.2 The Safeguards Agreement

The Safeguards Agreement amplifies and supplements GATT Article XIX. It was concluded in the Uruguay Round. In the Tokyo Round, the negotiating parties had discussed an agreement to implement Article XIX but failed to reach agreement. The Safeguards Agreement was influenced by the experience of the United States under section 201 of the Trade Act of 1974 and reflects the substance of that US law.[5]

3.3 The relationship between GATT Article XIX and the Safeguards Agreement

The Appellate Body tends to construe the requirements of Article XIX and the Safeguards Agreement together. According to the Appellate Body in the *United States—Line Pipe* case,[6] there are two basic inquiries in a safeguards case:

1. Is there a right to apply a safeguard measure?
2. If so, has this right been exercised within the limits set out in the Safeguards Agreement?

In the first cases under the WTO safeguards regime, the issue of the relationship between GATT Article XIX and the Safeguards Agreement arose in the context of the 'unforeseen developments' requirement.[7] This requirement is included in GATT Article XIX:1(a) but is not repeated in the Safeguards Agreement.

[5] See, for example, Thomas V. Vakerics et al., *Antidumping, Countervailing Duty and Other Trade Actions* (Practicing Law Institute, 1987 & 1989 Supp.) (discussing practice under the Trade Act of 1974, s. 201).

[6] Appellate Body report, *US—Line Pipe*, para. 84.

[7] See Panel report, *US—Line Pipe*, paras. 7.293–7.300, 8.1(6); Appellate Body report, *US—Lamb*, paras. 65–76; Panel report, *US—Lamb*, paras. 7.32–7.45; Appellate Body report, *Korea—Dairy*, paras. 68–77;

One issue was whether Article XIX:1(a) conflicts with provisions of the Safeguards Agreement. In the event of a 'conflict', the provisions of the Safeguards Agreement prevail.[8] The term 'conflict' is not defined but has been interpreted by the Appellate Body to mean a situation 'where adherence to the one provision will lead to a violation of the other provision'.[9] The Appellate Body held that Article XIX:(a) and the Safeguards Agreement should be read together since the Safeguards Agreement defines a safeguard measure under this Agreement as that of Article XIX:1(a). This holding implies that there is no conflict between Article XIX:1(a) and the Safeguards Agreement.[10]

The Appellate Body has also concluded that safeguard measures imposed after the entry into force of the WTO Agreement must comply with the provisions of *both* the Article XIX of the GATT and Safeguards Agreement.[11] The Appellate Body reasoned as follows: Legal effect must be given to all provisions of the WTO Agreement, which includes both the GATT 1994 and the Safeguards Agreement.[12] The Safeguards Agreement 'establishes rules for the application of safeguard measures which shall be understood to mean those measures provided for in Article XIX of GATT'.[13] The Safeguards Agreement prohibits WTO members from applying safeguard measures unless such measures conform to the provisions of GATT 1994 Article XIX applied in accordance with the Safeguards Agreement.[14] This position was restated by the Appellate Body in *US—Steel Safeguards* in which it stated that GATT Article XIX and the Safeguards Agreements must be read as an 'inseparable package of rights and disciplines'.[15] There is no indication that the Uruguay Round negotiators intended to subsume the requirements of GATT 1994 Article XIX within the Safeguards Agreement and thereby render those requirements no longer applicable. Thus, safeguard measures are reviewed under both the GATT and the Safeguards Agreement.

3.4 Investigation

WTO members may not impose safeguard measures without first conducting an investigation regarding the necessity of such measures. Article 3.1 of the Safeguards

Panel report, *Korea—Dairy*, paras. 7.33–7.48; Appellate Body report, *Argentina—Footwear*, paras. 76–84; Panel report, *Argentina—Footwear*, paras. 8.47–8.69.

[8] General Interpretive Note to Annex 1A, Multilateral Agreements on Trade in Goods, of the WTO Agreement, World Trade Organization, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (Cambridge University Press, 1999) 16. This note reads as follows: 'In the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization (referred to in the agreements in Annex 1A as the "WTO Agreement"), the provision of the other agreement shall prevail to the extent of the conflict'.

[9] Appellate Body report, *Guatemala—Cement*, para. 65.

[10] Appellate Body report, *Argentina—Footwear*, para. 89.

[11] See ibid. para. 81; Appellate Body report, *Korea—Dairy*, para. 77.

[12] See WTO Agreement Art. II:2 (stating that the agreements included in Annexes 1, 2, and 3 are part of the WTO Agreement). The GATT 1994 and the Safeguards Agreement are both contained in Annex 1A of the WTO Agreement.

[13] Safeguards Agreement Art. 1.

[14] Ibid. Art. 11.1(a).

[15] Appellate Body report, *US—Definitive Safeguard Measures on Imports of Certain Steel Products*, WT/DS248.249,251,253,254,258,259/AB/R, adopted on 10 December 2003, paras. 275–9.

Agreement sets out the requirements for the investigation. The national authorities conducting the investigation must give public notice of the investigation to interested parties. Exporters, importers, and other interested parties must be given an opportunity to express their views on the matter, including their views on whether the application of a safeguard measure would be justified by the public interest. The national authorities must publish a report 'setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law'.[16]

In addition, WTO members must 'immediately' notify the Committee on Safeguards of its initiation of an investigation.[17] In the *US—Wheat Gluten* case, the Appellate Body held that a delay of even a few weeks violates this requirement.[18]

3.5 Provisional application

WTO members may impose provisional safeguard measures in 'critical circumstances where delay would cause damage which it would be difficult to repair', provided they first make a preliminary determination that there is 'clear evidence that increased imports have caused or are threatening to cause serious injury'.[19] The maximum period of a provisional measure is 200 days, and the period in which a provisional measure is applied is included in the total period of the safeguard measure.[20] Provisional safeguard measures must take the form of tariff increases.[21]

3.6 Determination of increased imports

There must be an increase of imports 'in such increased quantities' as to cause or threaten serious injury.[22] The increase can be absolute or relative to domestic production.[23] The Appellate Body found, in *Argentina—Footwear*, that the phrase 'in such increased quantities' requires that the increase must have been 'recent enough, sudden enough, sharp enough and significant enough, both quantitatively and qualitatively, to cause or threaten to cause "serious injury"'.[24]

However, in making a determination of increase in imports, an investigating authority (IA) cannot take a simple end point to end point analysis, that is, a comparison of the quantity or value of imports at an early time point in the investigative period and at the end of the period. An IA should make an evaluation of the trend of imports during the entire period of investigation. This was an issue in *US—Steel Safeguards*.[25] In this case, the United States argued that a two-end point analysis would be sufficient. The Appellate Body, however, rejected this argument and held that a single end point to end point comparison could easily be manipulated to lead to a wrong result depending on the choice of end points. The Appellate Body rejected the United States' claim that the phrase 'in such increased quantities' in GATT Article XIX simply states the

[16] Safeguards Agreement Art. 3.1. [17] Ibid. Art. 12.1(a).
[18] Appellate Body report, *US—Wheat Gluten*, paras. 108–12. [19] Safeguards Agreement Art. 6.
[20] Ibid. [21] Ibid. [22] GATT Art. XIX:1(a); Safeguards Agreement Art. 2.1.
[23] Safeguards Agreement Art. 2.1. [24] Appellate Body report, *Argentina—Footwear*, para. 131.
[25] Appellate Body report, *US—Definitive Safeguard Measures on Imports of Certain Steel Products*, WT/DS248,249,251,253,258,258/AAB/R, 10 December 2003.

requirement that the level of imports at the end of a period of investigation be higher than at some unspecified earlier point in time.[26]

3.7 Unforeseen developments

The increase of imports must be caused by 'unforeseen developments'. A literal interpretation of this phrase suggests that a safeguard measure may not be applied unless the injury to a domestic industry was caused by developments that were not foreseen at the time of the latest trade negotiation. The Appellate Body found that the national authorities must demonstrate unforeseen developments before applying a safeguard measure.[27] It is not sufficient for the national authorities merely to describe certain new developments.[28] National authorities must show that an increase of imports has been caused by events that were not unforeseen at the time of concessions of tariffs, for example, at the time when the last tariff negotiation was concluded (the conclusion of the Uruguay Round Negotiation in 1993).[29]

The Appellate Body noted that 'unforeseen developments' modifies the phrase 'being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory'.[30] The Appellate Body interpreted 'unforeseen developments' to be part of 'circumstances' in which a sharp increase of imports occurs in such a way as to cause a serious injury to a domestic industry.[31] The Appellate Body concluded that it is necessary for IAs to make findings that unforeseen developments exist and that a logical connection exists between the conditions set forth in Article XIX:1(a) and the circumstances such as 'unforeseen developments'.[32] If the Appellate Body means that 'unforeseen developments' is a requirement that must be established by the country invoking the safeguard measures and is a part of the circumstance surrounding a sharp increase of imports, it means that this requirement must be established independently.

In *US—Steel Safeguards*, one of the issues was whether or not the 'unforeseen developments' requirement should be established with regard to each specific product when imports of a broader category of products is under investigation. In this case, ten steel products were subject to the safeguard measures. The question was whether the IA had to establish that unforeseen developments resulted in an increase in the import of each of those products. The Appellate Body stated that when an importing member wishes to apply safeguard measures on imports of several products, it is not sufficient

[26] *US—Steel Safeguards*, paras. 353–6.

[27] Appellate Body report, *US—Lamb*, para. 72 (holding that unforeseen developments must be demonstrated '*before* the safeguard measure is applied') (emphasis in original); Appellate Body report, *Argentina—Footwear*, para. 81 (holding that unforeseen developments 'must be demonstrated as a matter of fact'); Appellate Body report, *Korea—Dairy*, para. 75 (holding that unforeseen developments 'must be demonstrated as a matter of fact').

[28] Appellate Body report, *US—Lamb*, para. 73.

[29] Appellate Body report, *Argentina—Definitive Safeguard Measure on Imports of Preserved Peaches,* WT/DS 238/R/DSR 2003: III, 1037, adopted 15 April 2003, para. 7.35; Panel report, *Dominican Republic—Safeguard Measures,* WT/DS 415, 416, 417, 418R, adopted 22 February 2012, paras. 128–9.

[30] Appellate Body report, *Argentina—Footwear*, para. 92. [31] Ibid.

[32] Appellate Body report, *United States—Lamb*, para. 72.

merely to demonstrate that unforeseen developments resulted in increased imports of a broad category of products that included the specific products subject to the respective determinations by the competent authority.[33]

Some commentators have previously suggested that the Report of the Working Party in *Hatters' Fur*[34] read 'unforeseen developments' out of Article XIX.[35] In *Hatters' Fur*, the United States invoked a safeguard measure on imported fur products, and Czechoslovakia challenged the measure under Article XIX. The *Hatters' Fur* Working Party found that changes in fashion of women's hats amounted to 'unforeseen developments' and upheld the position of the United States.

To state that the *Hatters' Fur* report read 'unforeseen developments' out of GATT Article XIX seems to be inaccurate (or at least overstated). This report did, however, interpret 'unforeseen developments' liberally and, therefore, the threshold for invoking a safeguard measure was set at a low level. Even if 'unforeseen developments' is an independent requirement, it should not be difficult to establish this requirement. Indeed, any development (such as a change in currency value, a technological breakthrough, or a change in consumers' preferences) that causes an increase of imports is generally unforeseen at the time of trade negotiation. Who can predict what change in currency value would take place or what technological breakthrough might occur two or three years after the conclusion of a trade negotiation?

A safeguard measure under GATT Article XIX and the Safeguards Agreement is an emergency measure to deal with an increase of imports that is not necessarily unfair. To enable members to invoke safeguard measures easily would undermine the foundation of the liberal trade order enshrined in the WTO system. In this respect, it makes sense to require the existence of 'unforeseen developments' before safeguard measures may be invoked because this requirement will act as a safety mechanism to prevent safeguard measures from being used excessively.

3.8 Determination of injury

3.8.1 Serious injury or threat of serious injury

Before imposing safeguard measures, WTO members must make a determination of serious injury or threat thereof to a domestic injury. The standard of 'serious injury' has been found to be higher than that of 'material injury', which is the standard for antidumping and countervailing measures.[36] The injury to a domestic industry should be greater when imposing a safeguard measure than when imposing an antidumping or countervailing duty, because safeguards are designed to counteract imports that are not unfair, whereas antidumping and countervailing duties are designed to counteract

[33] *US—Steel Safeguards*, paras. 314–19.

[34] Report of the Intersessional Working Party on the Complaint of Czechoslovakia Concerning the Withdrawal by the United States of a Concession under the Terms of Article XIX, GATT/CP/106, 27 March 1951.

[35] John H. Jackson, *World Trade and the Law of GATT* (The Bobbs-Merill Company, Inc., 1969) 560–1; Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade*, 3rd edn. (Routledge, 2005) 228.

[36] Appellate Body report, *US—Lamb*, para. 124.

unfair trade practices. The serious injury standard is intended to strike a balance between the need of a domestic industry for relief from an import surge and that of purchasers of imports and consumers in general for lower-cost imports.

In the *US—Line Pipe* case, the Appellate Body rejected the argument that there must be a discrete determination of both serious injury and threat thereof.[37] Either finding will establish the right to apply safeguard measures.[38]

3.8.1.1 Serious injury

The term 'serious injury' is defined to mean 'a significant overall impairment in the position of a domestic industry'.[39] As the Appellate Body stated in *Argentina—Footwear*, there must be a 'significant overall impairment' of the situation regarding the domestic industry in question.[40] In other words, there must be not only an upward trend in the volume or market share of imports, but also a deterioration of the situation as a whole with respect to the domestic industry seeking relief.

In *Argentina—Footwear*, Argentina found serious injury by comparing figures of imports at two points in time. Although the Panel stated that the trend of imports must be examined during the entire period of investigation, it held that, if a decrease of imports is more than temporary, it is doubtful whether there has been an increase of imports. The Panel ruled that the government invoking a safeguard measure is required to examine whether an increase of imports and the downward trends of factors of injury coincide, and whether there is a cause other than imports that contributes to the serious injury. The Panel held that, in any event, an examination of trends is important. The Appellate Body generally upheld the rulings of the Panel.

3.8.1.2 Threat of serious injury

The term 'threat of serious injury' is defined to mean 'serious injury that is clearly imminent'.[41] A determination of threat of injury must be based on facts and not merely on allegation, conjecture, or remote possibility.[42] In the *US—Lamb* case, the Appellate Body dealt with the issue of how to interpret the term threat of serious injury. According to the Appellate Body, 'threat of serious injury' means that there must be 'a high degree of likelihood that the anticipated serious injury will materialize in the very near future'.[43]

Investigating authorities must explain how the facts relating to prices support a determination that the domestic industry is threatened with serious injury. In *US—Lamb*, the Appellate Body found that over the five-year period of investigation, the price of lamb had generally increased, and then decreased and increased again at the end of the period, and, as a result, the price was higher at the end of the period than it had been at the beginning. The Appellate Body also found that these overall trends raised doubts about the adequacy of the US position. The Appellate Body concluded

[37] Appellate Body report, *US—Line Pipe*, WT/JDS202/AB/R/DSR 2002-IV, 1403.
[38] Ibid. paras. 162–4. [39] Safeguards Agreement Art. 4.1(a).
[40] Appellate Body report, *Argentina—Footwear*, para. 139.
[41] Safeguards Agreement Art. 4.1(b). [42] Ibid.
[43] Appellate Body report, *US—Lamb*, para. 136.

that the US determination that the domestic industry was threatened with such injury was inconsistent with Article 4.2 (a) of the Safeguards Agreement because the United States had failed to explain how the facts relating to prices supported its determination.

3.8.1.3 Factors to be considered when determining injury or threat thereof

The national authorities charged with making an injury or threat determination must evaluate 'all relevant factors' that are objective and quantifiable and that bear upon the situation of the relevant domestic industry.[44] According to Article 4.2(a) of the Safeguards Agreement, relevant factors include the 'rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, and changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment'.

The Appellate Body ruled that the national authorities must evaluate all of the factors listed in Article 4.2(a) as well as all other relevant factors, not merely the factors raised by the parties.[45] The Appellate Body qualified its statement by saying that national authorities do not have an open-ended and unlimited duty to investigate all available facts.[46] The Appellate Body recognized that national authorities may not have data pertaining to all domestic producers, but stated that the data must be sufficiently representative to give a true picture of the domestic industry.[47]

Not all factors need to show a downward trend, however, because the issue is whether there is a 'significant overall impairment' of the domestic industry or threat thereof.[48] Such impairment can occur even if one or more factors show an upward trend, provided the facts as a whole support the determination of serious injury or threat thereof.

3.8.1.4 Domestic industry

Safeguard measures may be applied to imports when the IAs determine that there is a serious injury or threat thereof to a 'domestic industry'.[49] Domestic industry is defined as 'the producers as a whole of the like or directly competitive products operating within the territory of a Member, or those whose collective output of the like or directly competitive products constitutes a major proportion of the total domestic production of those products'.[50] In *US—Lamb*, the Appellate Body dealt with one aspect of the issue of what constitutes a domestic industry. In that case, the United States imposed a safeguard measure on imports of lamb meat. The United States claimed that the producers of lamb meat included growers and feeders of live lambs (i.e. upstream producers) because there is a continuous line of production from the one to the other, and there is commonality of economic interests between the producers of the raw product and the producers of the end product. The Panel rejected this argument and

[44] Safeguards Agreement Art. 4.2(a).
[45] Appellate Body report, *US—Wheat Gluten*, paras. 55–6; Appellate Body report, *Argentina—Footwear*, para. 136.
[46] Appellate Body report, *US—Wheat Gluten*, para. 56. [47] Ibid. para. 57.
[48] Appellate Body report, *Argentina—Footwear*, para. 139; Panel report, *US—Wheat Gluten*, para. 1.85.
[49] Safeguards Agreement Art. 2.1. [50] Ibid. Art. 4.1(c).

held that the domestic industry consists of only producers that have output of like or directly competitive products. The Appellate Body upheld this finding.

3.8.2 Causation

The issue of causation plays a central role in any safeguards investigation. Article 4.2(b) of the Safeguards Agreement provides as follows:

> [An injury or threat determination] shall not be made unless [the] investigation demonstrates . . . the existence of the causal link between increased imports . . . and serious injury or threat thereof. When factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to increased imports.

Article 4.2(b) contains two distinct legal requirements: (1) a causal link between increased imports and the serious injury or threat thereof; and (2) the requirement that other causal factors not be attributed to increased imports.[51] The so-called non-attribution requirement cannot be satisfied by mere assertions. The various causal factors must be disentangled, and there must be a reasoned and adequate explanation of how the factors causing injury and those not causing injury are distinguished.[52]

First, the national authorities conducting the investigation must examine whether increased imports are causing or threatening to cause serious injury. According to the Appellate Body, increased imports will be found to cause or threaten to cause serious injury if such imports clearly contribute to bringing about, producing, or inducing the serious injury or threat thereof.[53] The Appellate Body has pointed out that 'the need to distinguish between the effects caused by increased imports and the effects caused by other factors does *not* necessarily imply . . . that increased imports *on their own* must be capable of causing serious injury, nor that injury caused by other factors must be *excluded* from the determination of serious injury'.[54]

According to the Appellate Body, the national authorities must determine whether the effects of increased imports establish '*a genuine and substantial relationship* of cause and effect' between the increased imports and serious injury or threat thereof.[55] In determining whether there is 'a genuine and substantial relationship of cause and effect' between the increased imports and serious injury or threat thereof, the Appellate Body set out the following 'logical process' for national authorities to follow:

1. Distinguish the injurious effects caused to the domestic industry by increased imports from the injurious effects caused by other factors.

[51] Appellate Body report, *US—Line Pipe*, para. 208.
[52] Ibid. paras. 209–14; Appellate Body report, *US—Lamb*, para. 179; Appellate Body report, *US—Wheat Gluten*, para. 70.
[53] Appellate Body report, *US—Lamb*, para. 166; Appellate Body report, *US—Wheat Gluten*, para. 67.
[54] Appellate Body report, *US—Wheat Gluten*, para. 70 (emphasis in original).
[55] Appellate Body report, *US—Lamb*, paras. 168, 177, 179 (emphasis added) (citing Appellate Body report, *US—Wheat Gluten*, para. 69).

2. Attribute to increased imports (on the one hand) and to other relevant factors (on the other hand) 'injury' caused by all of these different factors, including increased imports.
3. Determine whether a 'causal link' exists between increased imports and serious injury or threat thereof and, if so, whether this causal link involves 'a genuine and substantial relationship of cause and effect' between the increased imports and serious injury or threat thereof.[56]

Thus, the Appellate Body concluded that national authorities must explicitly establish, through a reasoned and adequate explanation, that injury caused by factors other than increased imports is not attributed to increased imports. The key is separating or distinguishing the effects of the different factors that bring about the injury.[57] In *US—Line Pipe*,[58] the Appellate Body confirmed this interpretation and added that the standard to be applied is similar to that developed in the context of the Antidumping Agreement. In particular, the Appellate Body cited *US—Hot-Rolled Steel from Japan*[59] and stated that national authorities must separate and distinguish the injurious effects of the increased imports from the injurious effects of the other factors.

3.9 Limits on the application of safeguard measures

The Appellate Body has distinguished the right to apply safeguards under Article XIX and the Safeguards Agreement from the limits on their application. There may be a right to apply safeguard, but a member must also observe the limits on their application. Thus, in imposing increased tariffs, quotas, tariff rate quotas, or other safeguard measures, the following limits must be observed.

3.9.1 Parallelism

Parallelism refers to the requirement that WTO members applying a safeguard measure must maintain a proportion or parallel between (1) the investigation and its findings; and (2) the scope of application of the safeguard measure. The so-called parallelism requirement comes from an interpretation by the Appellate Body of Article 2.1 and 2.2 of the Safeguards Agreement.[60] Article 2.1 concerns the legal conditions that must be fulfilled to invoke safeguard:

> A Member may apply a safeguard measure to a product only if that Member has determined, pursuant to the provisions set out below, that such product is being imported into its territory in such increased quantities, absolute or relative to domestic

[56] Appellate Body report, *US—Wheat Gluten*, para. 69. See also Appellate Body report, *US—Lamb*, para. 177.
[57] Appellate Body report, *US—Wheat Gluten*, para. 68.
[58] Appellate Body report, *US—Line Pipe*.
[59] Appellate Body report, *US—Hot-Rolled Steel from Japan*.
[60] Appellate Body report, *US—Line Pipe*, paras. 179–81.

production, and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products.[61]

Article 2.2 concerns the right to apply safeguard: 'Safeguard measures shall be applied to a product being imported irrespective of its source'.[62]

Both Article 2.1 and Article 2.2 use the phrase 'product . . . being imported'. There cannot, therefore, be a gap between the products covered in the investigation and the products subject to the safeguard measure. Rather, the products covered in the investigation and the products subject to the safeguard measure must parallel each other.[63] The parallelism requirement is further elaborated in Article 4.2, which concerns the causal link between increased imports and the serious injury or threat thereof to the domestic industry.[64]

The issue of parallelism between the investigation and the application of a safeguard measure arises most importantly in connection with non-application of a safeguard measure to imports from members of a free trade agreement (FTA) to which the country applying the measure is also a member. If, for example, Country X (a WTO member and an FTA member) investigates imports from all sources, but does not apply the safeguard measure to imports from the members of the FTA, Country Y (a WTO member but not an FTA member) may challenge this non-application as a violation of the Safeguards Agreement as well as, perhaps, the most favoured nation (MFN) treatment principle. The issue of parallelism is closely related to the question of whether, under GATT 1994 Article XXIV, a country that is a member of an FTA can lawfully apply a safeguard measure with respect to imports from another member of the FTA.

The issue of parallelism was taken up in the *Argentina—Footwear* case. In this case, the Panel held that the safeguard measure must be applied to imports from all countries, including members of the customs union, if imports from all sources, including those from the other customs union members, were taken into account in the safeguard investigation.[65] On appeal, the Appellate Body held that Articles 2.1 and 4.2 of the Safeguards Agreement require that an investigation evaluating imports from all sources can lead only to the imposition of safeguard measures on imports from all sources. The Appellate Body ruled that Argentina's investigation, which was based on an investigation of imports from all countries, including the MERCOSUR countries, could not, therefore, serve as a basis for excluding imports from other MERCOSUR countries from the application of the safeguard measure.

In *US—Wheat Gluten*, the Panel held that the United States had violated Articles 2.1 and 4.2 of the Safeguards Agreement by excluding Canada (a party to the North American Free Trade Agreement (NAFTA)) from the application of safeguard measures after including imports from all sources in its investigation. The United States appealed this finding, and the Appellate Body rejected the US claims on the ground

[61] Safeguards Agreement Art. 2.1 (footnote omitted). [62] Ibid. Art. 2.2.
[63] Appellate Body report, *United States—Line Pipe*, para. 181. [64] Ibid. para. 188.
[65] Panel report, *Argentina—Footwear*, para. 111 (citing Safeguards Agreement Art. 2.1, fn. 1).

that it was necessary for the United States to have shown that imports from countries other than Canada cause or threaten to cause serious injury to a domestic industry.

An important appellate ruling on this issue came in the *US—Line Pipe* case. In this case, the United States excluded imports from Mexico and Canada from the application of safeguard measures even though an investigation had been conducted with regard to serious injury caused by imports from countries including Mexico and Canada. Korea petitioned to the WTO and argued that the United States violated the principle of MFN treatment by excluding Mexico and Canada from the application of the safeguard measure. The Panel found a violation of provisions of the Safeguards Agreement on the part of the United States. The Panel also found that the United States was entitled to rely on GATT Article XXIV as a defence to a charge that it had violated the MFN principle.

Both the United States and Korea appealed. The Appellate Body ruled that the United States did not adduce sufficient evidence to show that imports from countries other than the NAFTA countries (Mexico and Canada) had caused a serious injury to the domestic industry. Regarding the cross-appeal by Korea arguing that the Panel was wrong to hold that the United States could rely on Article XXIV as a defence to a charge that it had infringed the MFN principle, the Appellate Body stated that the issue was disposed of by the holding and it was not, therefore, necessary to consider this question, and that the part of the Panel report dealing with whether Article XXIV constitutes a defence to a charge of a violation of the MFN principle was moot and had no legal effect.[66]

In the *US—Line Pipe* case, the Appellate Body held that the exclusion of NAFTA countries (Canada and Mexico) from a safeguard measure was a prima facie violation of the parallelism requirement because Korea had demonstrated that the United States 'considered imports from all sources in its investigation' and that 'exports from Canada and Mexico were excluded from the safeguard measure at issue'.[67] Thus, the burden was on the United States to rebut by providing a '*reasoned and adequate explanation* that *establishes explicitly* that imports from non-NAFTA sources satisfied the conditions for the application of a safeguard measure, as set out in Article 2.1 and elaborated in Article 4.2 of the *Agreement on Safeguards*'.[68]

The issue of parallelism was brought up again in the recent *US—Steel Safeguards* in which the United States took into consideration all imports as part of its injury investigation when determining whether they caused injury to the domestic industry but excluded Canada, Israel, Jordan, and Mexico from the application of the safeguard measures. The Appellate Body held that it was incumbent on the United States to justify this non-application by establishing clearly that imports from countries covered by the safeguard measures, that is, countries other than Canada, Israel, Jordan, and

[66] Appellate Body report, *US—Line Pipe*, para. 199. Although the Appellate Body exercised 'judicial economy' and avoided consideration of this issue, it was probably wrong for the Appellate Body to have dismissed this cross-appeal by Korea because DSU Art. 17.12 states that the Appellate Body shall address each legal issue raised in an appeal. This wording suggests that the Appellate Body may not exercise judicial economy.

[67] Appellate Body report, *US—Line Pipe*, para. 187.

[68] Ibid. para. 188 (italics in original).

Mexico, satisfy, alone, and in and of themselves, the conditions for an application of the safeguard measures.[69]

3.9.2 Non-attribution

Article 4.2 (b) of the Safeguards Agreement states:

> The determination of [serious injury] shall not be made unless this investigation demonstrates, on the basis of objective evidence, the existence of the causal link between increased imports of the product concerned and serious injury or threat thereof. When factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to the increased imports.

The first sentence requires that there is a causal link between increase of imports and serious injury and the second sentence provides for non-attribution of causes other than increased imports to serious injury.

3.9.3 Extent of safeguards

Important limits on the application of safeguards are contained in Article 5.1 of the Safeguards Agreement.

The first sentence of Article 5.1 requires that safeguard measures be applied 'only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment'. The 'extent necessary' requirement is a substantive obligation that the safeguard measure be limited to remedying the serious injury findings in Article 4.2. Thus, a member cannot apply safeguard to remedy the entirety of the serious injury but only that attributable to increased imports.[70]

The second sentence of Article 5.1 further requires that, if a quota is used as a safeguard measure, it 'shall not reduce the quantity of imports below the level of . . . the average of imports in the last three representative years . . . , unless clear justification is given that a different level is necessary to prevent or remedy serious injury'. This sentence contains a substantive requirement: if a quota is less than the three-year average, it must be necessary to prevent or remedy serious injury. There is also an explicit procedural requirement: 'clear justification' means that the member must make a clear demonstration.[71]

3.9.4 Selectivity

When WTO members apply safeguard measures in the form of a quota, they may allocate the quota among supplying countries based on an agreement with exporting members.[72] If an agreement is not reached, they may allocate the quota to members based on the proportion of products imported from those members during a

[69] *US—Steel Safeguards,* paras. 440–4. [70] Ibid. paras. 252–60.
[71] Appellate Body report, *US—Line Pipe*, para. 233. [72] Safeguards Agreement Art. 5.2(a).

representative period, for example, the past three years.[73] WTO members may deviate from this principle if the increase of imports from a given member is disproportionately large in relation to the total increase of imports.[74] This deviation from the principle of non-discrimination is called quota modulation. Quota modulation must be justified and equitable to the members interested in the matter.[75] Quota modulation is not, however, available in the case of only a threat of serious injury.[76] WTO members engaging in quota modulation must report to and consult with the WTO Committee on Safeguards.[77]

The issue of whether 'selective' safeguard measures should be permissible under GATT/WTO rules was a subject of controversy between the European Community and developing countries. Selective safeguard measures are measures applied to imports from one or selected countries but not to imports of other countries. The European Community wanted to include selective safeguard measures, but developing country members objected because they felt they would be the targets of such measures. Japan sided with developing countries in this issue. A compromise between different views on this subject was quota modulation.

3.9.5 Developing countries

WTO members must exclude developing country members whose import share is 3 per cent or less from the application of safeguard measures, unless the total import share of all such countries exceeds 9 per cent.[78] According to the Appellate Body, 'all reasonable steps' must be taken to comply with this exclusion.[79]

3.9.6 GATT Article XIII

Although GATT Article XIII regarding non-discriminatory administration of import quotas is modified by the Safeguards Agreement provision on selectivity,[80] two obligations in Article XIII:2(a) remain. First, traditional trade patterns must be respected in allocating quotas.[81] Second, the total amount of imports permitted at the lower tariff rate must be fixed (not merely the individual quotas for each country).[82]

3.9.7 Duration and review

In principle, safeguard measures are temporary and should not be prolonged beyond the necessary period. In light of this principle, the maximum period for a safeguard measure is four years.[83] A safeguard measure may be extended if the national authorities decide that it is necessary to do so.[84] The total period of a safeguard measure may

[73] Ibid. [74] Ibid. Art. 5.2(b).
[75] Ibid. WTO members may not engage in quota modulations if there is only a 'threat of serious injury.' Ibid.; see also, for example, Appellate Body report, *US—Line Pipe*, para. 173.
[76] Safeguards Agreement Art. 5.2(b). [77] Ibid. [78] Ibid. Art. 9.1.
[79] Appellate Body report, *US—Line Pipe*, paras. 132–3. [80] See section 3.9.3.
[81] Appellate Body report, *US—Line Pipe*, para. 79. [82] Ibid.
[83] Safeguards Agreement Art. 7.1. [84] Ibid. Art. 7.2.

not be more than eight years. If the period in which a safeguard measure is applied extends beyond one year, there must be a regular reduction of the measure.[85] If the safeguard period is more than three years, there must be an interim review and the measure must be withdrawn or there must be an acceleration of the reduction of the measure.[86] No safeguard measure can be taken with regard to a product on which a safeguard measure was applied at least for the period equal to that in which the safeguard measure was taken and, in any event, no safeguard measure can be taken with regard to that product at least for two years.[87]

A developing country member has the right to extend the period of safeguard for two years[88] beyond the eight-year maximum. It can also reapply a safeguard measure after a period equal to half that during which a measure has been previously applied, if the period of non-application is at least two years.[89]

3.10 Notification and consultation

Before applying or extending a safeguard measure, WTO members must provide an 'adequate opportunity for prior consultations' to members 'having a substantial interest as exporters' with a view to reaching an understanding on maintaining a 'substantially equivalent' balance of trade concessions.[90] Providing an adequate opportunity for prior consultations has been held to mean that the member proposing to apply the safeguard must provide 'sufficient information and time to allow for the possibility, through consultations, for a meaningful exchange' of views.[91] The time for advance notice is determined on a case-by-case basis.[92]

In the *US—Line Pipe* case, the United States announced the safeguard measure in a press release. The Appellate Body held this method of notification to be inadequate and a violation of Safeguards Agreement, Article 12.3 as well as Article 8.1.[93]

3.11 Compensation

GATT Article XIX:3 grants to members affected by safeguard measures the right to suspend 'substantially equivalent [trade] concessions' against the member invoking safeguard measures. The idea is that there should be a rebalancing of trade concessions vis-à-vis the members either voluntarily or involuntarily.

The Safeguards Agreement modifies this right to a considerable degree. WTO members invoking safeguard measures must offer to compensate other members to equalize the loss they would suffer from the invocation of the safeguard measures.[94] If an agreement cannot be reached between the invoking member and exporting

[85] Ibid. Art. 7.4. [86] Ibid. [87] Ibid. Art. 7.5. [88] Ibid. Art. 9.2. [89] Ibid. Art. 9.2.
[90] Ibid. Arts. 8.1, 12.3. See Appellate Body report, *US—Line Pipe*, para. 119; Appellate Body report, *US—Wheat Gluten*, para. 135. There is a link, therefore, between Art. 12.3 and Art. 8.1, and a violation of the consultation requirement is also a violation of Art. 8.1.
[91] Appellate Body report, *US—Line Pipe*, paras. 106–13; Appellate Body report, *US—Wheat Gluten*, para. 136.
[92] Appellate Body report, *US—Line Pipe*, para. 113. [93] Ibid. para. 119. [94] Ibid. Art. 8.1.

members, the latter can take retaliatory measures.[95] The right to retaliate is, however, limited.[96] If safeguard measures are applied in response to an increase of imports in absolute terms and conform to provisions of the Safeguards Agreement, the exporting members may not invoke retaliatory measures against those measures for a three-year period.[97] This limitation is provided so that members can invoke safeguard measures without fear that the exporting members will retaliate.

The three-year mandatory moratorium in the Safeguards Agreement on the right to suspend concessions creates a dilemma for WTO members adversely affected by a safeguard measure. Article 8.1 of the Safeguards Agreement provides that members proposing a safeguard 'shall endeavour' to maintain substantially equivalent reciprocal trade concessions, but there may be no practical means to enforce this right. If the member invoking the safeguard measure refuses consultation[98] and compensation, and safeguard is invoked in violation of the GATT and the Safeguards Agreement, affected parties have options that are less than satisfactory. First, an affected party may bring a complaint under GATT Articles XXII and XXIII and the DSU,[99] but it normally takes a year to get decision by the Appellate Body, and the losing party has up to fifteen additional months to comply after the adoption of an Appellate Body report.

Second, an affected party can seek an immediate suspension of equivalent concessions pursuant to Safeguards Agreement Article 8.2, but this is not possible for a safeguard measure taken as a result of an *absolute* increase in imports.

Third, an affected party may seek to invoke GATT Article XXVIII, which allows withdrawal of equivalent trade concessions by members affected by a modification of another member's schedule of concessions. However, it would appear that Article XXVIII does not apply and would not, in any case, supersede the Safeguards Agreement, which specifically concerns safeguards and retaliation.

This problem reflects the unresolved tension in the Safeguards Agreement itself regarding the purposes and objectives of safeguards. As discussed earlier,[100] a safeguard is a 'fair trade remedy',[101] but its purpose is unclear. WTO members must clarify the basic reason and purpose for a safeguard to clarify the right to compensation and retaliation. If, on the one hand, the purpose of a safeguard is to provide compensation for trade-injured workers or allow politicians in the safeguarding country to satisfy the public choice agenda, safeguards should be accompanied by a rebalancing of trade concessions between the safeguarding country and affected WTO members. This would dictate greater availability of compensation and retaliation by affected members. In this case, Article 8.3, which restricts this right, should be repealed or modified. If, on the other hand, the purpose of a safeguard is to provide 'breathing space', allow reforms, and provide a 'safety valve', the three-year moratorium on the right of retaliation seems justified. Where a member wrongfully invokes a safeguard, however,

[95] Ibid. Art. 8.2. [96] Ibid. Art. 8.3. [97] Ibid.

[98] The *Line Pipe* case states that Art. 8.1 is enforced in the first instance by the obligation to consult in Safeguards Agreement Art. 12.3. Appellate Body report, *US—Line Pipe*, para. 119.

[99] Safeguards Agreement Art. 14. [100] See section 1 of this chapter.

[101] Appellate Body report, *US—Line Pipe*, para. 80.

provision should be made for a different remedy such as a monetary fine or mandatory compensation.

3.12 The standard of review for safeguard disputes

When a WTO Panel or the Appellate Body determines whether a safeguard measure is consistent with WTO law, the standard of review is important because, without such a standard, there is no criterion for showing deference to the factual or legal findings of national authorities. Unlike the Antidumping Agreement, the Agreement on Safeguards is silent regarding the issue of standard of review. Thus, the applicable standard of review is DSU Article 11. As is evident from the cases discussed above, review by WTO adjudicating bodies tends to be far-reaching, and some violation of the norms in the Safeguards Agreement has been found in every case.

4. Safeguard Measures for Balance of Payment Reasons

4.1 The GATT

At the time of the GATT 1947, the contracting parties conducted international monetary policy through a system of par-value, fixed currency exchange rates, and the GATT is based upon that system. Under par-value exchange rates, changes in par-value, especially devaluation, are disruptive and to be avoided. Thus, when a country, for any number of reasons, experiences high demand for foreign currencies, crisis can result if currency reserves are inadequate. Two options exist to deal with this problem: (1) trade restrictions to reduce imports; and (2) changes in macro-economic policies.

With the passing of the era of par-value exchange rates and under the current system of floating rates, changes in demand for currencies are reflected in the exchange rate changes. These may vary dramatically over time, but usually only marginally in the short term. As a result, at present, trade restrictions for balance of payments reasons are no longer used by most WTO members with the exception of certain developing countries.[102]

The GATT contains extensive provisions allowing WTO members to adopt trade restrictions for balance of payments reasons.[103] The GATT does not exclude, but does not explicitly require a country experiencing balance of payments problems to adopt macro-economic policies lessening demand.[104]

The substantive requirements for balance of payments trade restrictions are contained in Article XII and Article XVIII, Section B, which is reserved to developing countries.[105] Both provisions allow a WTO member to impose trade restrictions to safeguard its financial position and balance of payments, but only to the extent

[102] For example, see 'IMF Approves Loans for Brazil and Uruguay', *The International Herald Tribune*, 21 June 2002, 17, col. 1.

[103] GATT Arts. XII, XIII, XIV, XV, and XVIII, section B.

[104] GATT Art. XII:3(d). GATT Art. XII:3(a) provides, however, that countries should adopt domestic policies that expand, rather than contract, international trade. See also GATT Art. XVIII:11.

[105] There are small differences between Arts. XII and XVIII. See Jackson, *World Trade and the Law of GATT* (1969), n. 35 at 689.

necessary (1) to forestall the imminent threat of or stop a serious decline in its monetary reserves; or (2) in the case of a country with very low reserves, to achieve a reasonable rate of increase of its reserves.[106]

Both Articles leave the determination as to what is a serious decline in reserves, a low level of reserves, or a reasonable rate of increase to the International Monetary Fund (IMF).[107] Thus, the IMF determines the legality of imposing or continuing balance of payments trade restrictions.

Moreover, both GATT Article XII:2(b) and Article XVIII:11 require the country applying trade restrictions to progressively remove them once balance of payments conditions improve. In the *Korean Beef* case, the GATT dispute settlement Panel relied upon Article XVIII:11 and the determination of the IMF that South Korea had adequate monetary reserves, to recommend that South Korea work out a timetable for the removal of import quotas on beef that had been maintained since 1967.[108]

In the *India—Agricultural, Textile and Industrial Products* case,[109] the Appellate Body further elaborated on the criteria for maintaining balance of payments trade restrictions. First, balance of payments trade restrictions may be maintained only if there is a 'clear probability' of the occurrence of one of the conditions of GATT Article XVIII:9: (1) a threat of a serious decline in monetary reserves; (2) a serious decline in monetary reserves; or (3) inadequate monetary reserves.[110] Second, in the absence of these conditions, balance of payments trade restrictions must be removed and may not be maintained merely because of a 'distant possibility' that balance of payments difficulties may recur.[111]

As for the products with respect to which trade restrictions may be imposed, the GATT leaves the choice fundamentally to the country applying the restrictions.[112] In making the choice, a country (1) must avoid 'unnecessary' damage to the commercial or economic interests of trading partners; (2) must not 'prevent unreasonably' the restrictions to impair regular channels of trade; and (3) must not prohibit the importation of commercial samples or 'prevent compliance with patent, trademark, copyright, or similar procedures'.[113]

Both Article XII and Article XVIII authorize the adoption of only one type of trade restriction—namely, quotas. Generally, quotas must be administered on a non-discriminatory basis[114] and must be allocated among supplier countries based on their expected shares of trade through country-specific quotas or import licences. The non-discrimination rule may be disregarded 'temporarily', with the consent of WTO members, by the trade-restricting country 'in respect of a small part of its

[106] GATT Arts. XII:2, XVIII:9.

[107] GATT Art XV:2. See Debrah E. Siegel, 'Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements' (2002) *AJIL* 96, 561.

[108] *Republic of Korea—Restrictions on Imports of Beef*, 7 November 1989, GATT B.I.S.D. (36th Supp.) at 268 (1990) (hereinafter: the *Korean Beef* case).

[109] Appellate Body report, *India—Agricultural, Textile and Industrial Products.*

[110] Ibid. paras. 110–14.

[111] Ibid. para. 115.

[112] Art. XII:3(b) provides that restrictions can be given to the importation of 'those products which are more essential'. Art. XVIII:10 similarly allows 'priority to the importation of those products which are more essential in the light of its policy of economic development'.

[113] GATT Arts. XII:3(b), XVIII:10.

[114] GATT Art. XIII.

external trade' where the benefits to the member 'substantially outweigh' any injury to the trade of other members.[115]

Procedurally, quotas for balance of payments purposes can be adopted unilaterally, but the trade-restricting state must 'immediately' enter into consultations with other WTO members.[116] After the initial consultations, the quotas must be reviewed periodically.[117] If trade restrictions are at any time being applied inconsistently with applicable standards, the WTO may release the aggrieved party or parties from appropriate GATT obligations, thus allowing retaliation through the suspension or modification of trade concessions.[118] A developing country against which trade retaliation is adopted has the right to withdraw from the GATT on sixty days' notice.[119]

In practice, the GATT provision for trade restrictions for balance of payments purposes has never operated the way it was apparently intended, and, in fact, its primary rationale was lost after the end of the Bretton Woods system of par-value exchange rates. Under the current system of floating exchange rates, the need for reserves is now limited to central bank intervention in foreign exchange markets. Rather than intervening to defend exchange rates, countries can simply let the exchange rate move to market-driven levels.

Even before the demise of the Bretton Woods system of par-value exchange rates, balance of payments trade restrictions were not used according to GATT norms. When the United States adopted balance of payments trade restrictions in August 1971, it imposed a 10 per cent import surcharge rather than quotas. This action withstood a court challenge under US law,[120] but was never tested under the GATT. In recent years, the balance of payments exception has been invoked only by developing countries. For example, in 1983, Brazil invoked the provisions of GATT Article XVIII to justify 361 quotas.[121] Other countries invoking this provision to justify selected quotas were Ghana, India, Korea, Nigeria, Pakistan, and Tunisia, to name a few.[122] This experience shows that the balance of payments exception has been used under extremely doubtful circumstances to justify highly selective, rather than across the board, quotas.[123]

4.2 The WTO

A good case could be made for the abolition of any right under the GATT to impose trade restrictions for balance of payment reasons because of the demise of the Bretton Woods par-value exchange system. However, at the conclusion of the Uruguay Round, the negotiating parties chose to retain the GATT provisions unchanged as a part of the GATT 1994 but to adopt an Understanding on the Balance-of-Payments Provisions of

[115] GATT Art. XIV. [116] GATT Arts. XII:4(a), XVIII:12(a).
[117] GATT Arts. XII:4(b), XVIII:12(b), (c)(i). [118] GATT Arts. XII(c), (d), XVIII:12(c)(ii),(d).
[119] GATT Art XVIII:12(e).
[120] *United States v Yoshida Int'l Inc.*, 526 F.2d 560 (C.C.P.A. 1975).
[121] Reported in Isaiah Frank, 'Import Quotas, the Balance of Payments and the GATT' (1987) *World Economy* 10, 307.
[122] Reported in ibid. 313.
[123] See, for example, the *Korean Beef* case, n. 108. See also Richard Eglin, 'Surveillance of Balance of Payments Measures in the GATT' (1987) *World Economy* 10, 1.

the General Agreement on Tariffs and Trade 1994[124] as part of the WTO Agreement. This Understanding makes several changes in the balance of payments exception.

In the WTO, the Balance of Payments Committee handles legal and policy questions concerning balance of payments in the first instance, but resort can be made to dispute settlement under the DSU as well.

In the WTO Understanding, members are authorized to give preference to 'price-based' measures for balance of payments purposes because such measures have the least disruptive effect on trade.[125] Price-based measures include import surcharges, import deposit requirements, and other equivalent trade restrictions.[126] If quotas are used, members must provide justification as to the reasons price-based measures are inadequate.[127] The Understanding provides specifically that such price-based measures may be in excess of the GATT-bound duties under GATT Article II.[128] The Understanding, therefore, validates the state practice of the 1960s and early 1970s, when the United States, the United Kingdom, and other countries used price-based measures for balance of payments problems.

The Understanding also makes several other improvements in balance of payments trade measures. Restrictive import measures are to be taken only 'to the extent necessary to address the balance of payments situation'. Generally, they must not target specific products but must be applied to 'control the general level of imports'; only 'essential products' may be excluded.[129] The Understanding requires that the trade measures should be administered in a 'transparent' manner and must be notified to the WTO General Council.[130] Time schedules for the removal of the trade measures must be announced publicly 'as soon as possible'.[131]

The WTO Understanding is an improvement over the GATT balance of payments provisions because it is based on sound economic principles. If trade intervention is to occur, an across the board tariff surcharge is superior to quantitative restrictions. There are several reasons why this is so. First, administratively they are easier to apply and to remove; second, their disruptive effect will be less, to the extent they are spread over many goods and economic sectors; third, a broad-based surcharge will tend to avoid unfair discrimination; and fourth, import surcharges add directly to reserves and still allow imports, at least in principle.

Nevertheless, there are grounds to doubt whether the WTO Understanding, in attempting to preserve an archaic GATT exception, has sown the seeds of future problems. Although the WTO has gone to great lengths to reform the balance of payments provisions so that they will be used as they were during the Bretton Woods system, they almost certainly will not be used that way, since the Bretton Woods system is no more. Instead, the WTO Understanding may clear the way for across the board import surcharges to cure trade deficit problems and currency exchange imbalances, which have replaced balance of payments problems in the post-Bretton Woods world.

[124] Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade, reprinted in WTO, *The Legal Texts* (1999) 22.
[125] Ibid. para. 2. [126] Ibid. [127] Ibid. para. 3. [128] Ibid. paras. 2 and 3.
[129] Ibid. para. 4. [130] Ibid. paras. 4 and 9. [131] Ibid. para. 1.

Despite the fact that the WTO elected to retain the possibility of trade restrictions to cure balance of payments problems, there is reason to believe that current policies make this impossible. This is because the GATT Article XV:2 makes the IMF the sole judge of whether a country has experienced a serious decline, a very low level, or a reasonable rate of increase in its monetary reserves. Thus the IMF, in effect, has the power to determine the appropriateness of a country's invocation of Article XII or Article XVII, Section B, to justify the restriction of trade. But the IMF's usual remedy for a balance of payments crisis is not trade restrictions but fiscal and monetary discipline imposed on a country in return for a loan package.

5. Safeguard Measures in Textile and Clothing Trade

Before the WTO Agreement entered into force, the Multifibre Arrangement (MFA) authorized country-specific safeguard measures for textile and clothing imports. The MFA operated on the basis of bilateral trade agreements between trading countries. The WTO Agreement on Textiles and Clothing (ATC) replaced the MFA. Under the ATC, safeguard measures were permitted only on a member-by-member basis.[132] The ATC permitted such safeguard measures because textile industries generally consist of small businesses and employ a large number of people, many of whom are unskilled and cannot easily be shifted to other sectors. The ATC was, however, scheduled to terminate after ten years and it was terminated in 2005.[133] After this transition period, textile and clothing trade is now integrated into the GATT 1994. Safeguard measures on textile and clothing imports are regulated by GATT 1994 Article XIX.

In *US—Underwear*, Costa Rica challenged a US import quota on underwear from Costa Rica and argued that the imposition of an import quota was based on improper findings of serious damage caused to the domestic industry. The Panel agreed that the United States had not demonstrated that serious damage or threat thereof was caused by textile imports,[134] and the Appellate Body added a finding that the US safeguard was illegal because it was imposed with retroactive effect.[135]

6. Prohibition on Voluntary Export Restraints

6.1 Prohibition in the Safeguards Agreement

Voluntary export restraints (VERs), sometimes called voluntary restraint agreements (VRAs), are agreements between an exporting country and an importing country whereby the exporting country restrains its export of a product to the importing country at a request of the latter. These agreements were used often in the 1960s, 1970s, and 1980s between the United States and Japan, and the European Community and Japan. Prime examples are the VER in steel, which began in the late 1960s and lasted until the early 1990s; the VER in automobiles, which began in 1981 and lasted until the

[132] Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade, Art. 6.4.

[133] Ibid. Art. 9.

[134] Panel report, *US—Underwear*.

[135] Appellate Body report, *US—Underwear*.

early 1990s; and the Semiconductor Agreement, which began in 1986 and lasted until the early 1990s. Each of these was entered into between the United States and Japan.[136]

Generally, when there was a surge of imports from one country to another and domestic industries in the latter complained about the import pressures, the former requested the latter to restrain export voluntarily in accordance with its domestic laws and regulations and the latter complied with the request. This was a quick and easy way to resolve trade issues. This way of resolving trade conflicts was called 'bilateralism' because issues were dealt with and settled between the two countries.

VERs were, however, criticized as undermining the multilateral trading system, lacking transparency, and tending to distort the flow of trade and prolong restrictions.

In the Uruguay Round, the framers of the Safeguards Agreement decided to abolish VERs altogether, and a quid pro quo of abolishing VERs was the strengthening of the safeguard system by introducing quota modulation and the restriction of retaliation to import quotas under the Safeguards Agreement.

The Safeguards Agreement prohibits members from engaging in VERs by stating: 'a Member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side'.[137] It further continues: 'These include actions taken by a single Member as well as actions under agreements, arrangements and understandings entered into by two or more Members'. It should be noted that a member is prohibited not only from taking or maintaining VERs but also from 'seeking' them.

In the past, often an importing country conveyed an informal message to an exporting country without any formal trade negotiation that there would be trade issues either by way of imposing import quotas, invocation of antidumping laws, or otherwise, unless import pressure was reduced by whatever means available to the exporting country. The exporting country would agree to this informal request and put into effect a VER restraining export of the products in question to the importing country. Ostensibly, this could be viewed as a unilateral action of the exporting country. It is clear that such a view is contrary to the reality. In fact, the exporting country is pressured into taking this measure by the request of the importing country. One of the prime examples of this is the United States–Japan Automobile Arrangement (1980). The US auto industry (Ford Motor Company and the United Autoworkers of America) petitioned to the US authorities that it had been seriously injured by reasons of increase of auto imports from abroad and a restrictive measure be taken to rescue the industry. However, the US International Trade Commission denied relief on the ground that the injury was not caused by imports. In its view, the injury was caused by a failure of the US auto industry to shift to the production of smaller cars in the face of increasing energy costs.[138] Then the US government 'explained' to the Japanese government that there was significant unemployment in the auto industry in the United States and the US Congress could

[136] For discussions on VERs between the United States and Japan, see Chapter 22 of Industrial Structure Council of the Japanese Government, *Report on Unfair Trade Policies by Major Trading Partners* (1993), at 66–7, 59–60, 66–9, A5–A6, and A10–A11.

[137] Safeguards Agreement Art. 11(b).

[138] *Motor Vehicles and Certain Chassis and Bodies Therefor*, Investigation No. TA-201-44, USITC Publication 1110 (1980).

move to restrict imports of cars from abroad unless some remedial measures were taken. By this statement, the US government did not explicitly request the Japanese government to restrain export of cars to the United States. However, this statement had the effect of persuading the Japanese government to take a measure to restrain export. The Japanese government decided to take measures to limit the export of cars from Japan to the United States to 1.68 million cars annually.[139]

Similarly VERs were often used in the steel and semiconductor areas to deal with trade disputes between the United States and Japan.[140]

The negotiating parties of the WTO agreements considered this issue and decided to prohibit VERs whether they were formal or informal agreements or whether they were carried out at the initiative of the exporting country or at the request of the importing country.

Although VERs cannot be lawfully maintained under the Safeguards Agreement, protectionist pressures have not gone away. What remains to be seen is whether the Safeguards Agreement and GATT 1994 Article XIX are effective enough to keep protectionism at bay.

6.2 Tension between voluntary export restraints and competition policy

VERs involved not only governmental measures but also private conduct on the part of exporters and importers in the way of export and/or import cartels. Such cartels were often instigated and directed by governmental pressures. However, such restrictive conduct created tensions with antitrust laws. This is an important issue and we will discuss it in Chapter 22 in relation to competition policy.

[139] See, for details of the US/Japan Auto VER, Letter from William French Smith, US Attorney General, to Yoshio Okawara, Japanese Ambassador to the United States (7 March 1981), reprinted in *US Import Weekly* (BNA), 13 May 1981, M-1 to M-2. On the auto VER between the United States and Japan, see Donald E. deKieffer, 'Antitrust and the Japanese Auto Quotas' (1982) *Brook. J. Int'l L.* 8, 59; Mitsuo Matsushita and Robert Repeta, 'Restricting the Supply of Japanese Automobiles: Sovereign Compulsion or Sovereign Collusion?' (1982) *Case W. Res. J. Int'l L.* 14, 47; Michael W. Lochmann, 'The Japanese Voluntary Restraint on Automobile Export: An Abandonment of the Free Trade Principles of the GATT and the Free Market Principles of United States Antitrust Laws' (1986) *Harvard Int'l L. J.* 27, 99. On the issue of antitrust liability of US officials when they negotiated directly with foreign producers to limit export to the United States, see Letter from William French Smith, US Attorney General, to William E. Brock, US Trade Representative (18 February 1981), reprinted in *US Import Weekly* (BNA), 13 May 1981.

[140] For the US/Japan VER agreement, see *Japan—Trade in Semi-Conductors*, 4 May 1988, GATT B.I.S.D. (35th Supp.) at 116 (1989). For antitrust implications of VER in steel, see *Consumers Union of U.S., Inc. v Kissinger*, 506 F.2d 136 (D.C. Cir. 1974) and *Consumers Union of U.S., Inc. v Rogers*, 352 F. Supp. 1319, 1323–4 (D.C. 1973).

13

Technical Regulations, Standards, and Health Measures

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1. The Role of the TBT and SPS Agreements

Standards determine conditions that goods have to satisfy in order to be marketable. They ensure, first, safety and reliability for consumers (for instance by determining what chemicals must not be found in children's toys, or what bacteria must never be found in canned peanuts, etc.). Secondly, they facilitate commerce to a considerable extent, both within a state and internationally: the printer industry appreciates that ordinary consumers will use either paper that is (*Deutsche Industrie Norm* (DIN)) 'A4' size or 'US letter' size; the car manufacturer can ask for offers for a specified and standardized component, so that every producer of relevant parts knows what the client wants and may hence submit an custom-tailored offer. Thirdly, however, standards can prove to be market access impediments, and even be purposefully abused to serve that function: A country that imposes unique technical standards, may create (willingly or unintentionally) a very significant market access restriction.

As tariffs and other border measures have been successfully reduced since 1947, standards and other behind-the-border regulatory measures receive much more attention. That is, on the one hand, an opportunist reaction to the (partial) disappearance of a major trade impediment, which causes trade officials to address other problems for international trade. It is, however, also due to the fact that as it is no longer permissible to use tariff measures to restrict market access; this leaves behind-the-border discriminatory measures as a preferred tool for undoing specific trade liberalizations, thereby benefiting important domestic stakeholders which suffered from increased import competition. As a consequence, the drafters of the WTO Agreement included the Agreement on the Application of Sanitary and Phytosanitary Measures (hereinafter referred to as the SPS Agreement, or SPS) and the Agreement on Technical Barriers to Trade (hereinafter referred to as the TBT Agreement, or TBT) in Annex 1a of the WTO Agreement to deal with two different sub-sets of domestic regulatory measures. As a consequence, both Agreements form part of the single undertaking that is the Marrakesh Agreement. It goes without saying that both the TBT and the SPS are covered agreements for the purposes of the WTO dispute settlement mechanism.[1]

In substance, both Agreements represent a compromise 'between, on the one hand, the desire to avoid creating unnecessary obstacles to international trade and, on the other hand, the recognition of Members' right to regulate'.[2] This is, in principle, not 'different from the balance set out in the GATT 1994, where obligations such as national treatment in Article III are qualified by the general exceptions provision of Article XX'.[3]

2. The Legal Relationship between the GATT, TBT, and SPS

The General Agreement on Tariffs and Trade (GATT), the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS), and the Agreement on Technical Barriers to Trade (TBT) all address behind-the-border measures. 'In light of the interpretive principle of effectiveness', it is consistent WTO jurisprudence to apply all provisions of the WTO Agreements harmoniously, provided there is no legal command to the contrary.[4]

Such a situation exists with regard to the relationship between the SPS and the TBT. TBT Article 1.5 specifically excludes 'sanitary and phytosanitary measures as defined in Annex A of the Agreement on the Application of Sanitary and Phytosanitary Measures' from its scope. Likewise, SPS Article 1.4 provides that '[n]othing in this Agreement shall affect the rights of Members under the [TBT] with respect to measures not within the scope of this Agreement'. The SPS and the TBT are thus mutually

[1] Both Agreements contain certain *leges speciales* for dispute settlement: for example, purpose of the special or additional rules and procedures. Pursuant to TBT Art. 14.2, at the request of a party or on its own initiative, a Panel may seek the opinion of expert groups established for this purpose. Annex 2 to the TBT Agreement regulates in detail the procedure to be followed on this point. In *EC—Asbestos*, however, the Panel did not take up this opportunity but rather consulted experts individually; *EC—Asbestos* (Panel), para. 8.10 *et seq*.

[2] *US—Clove Cigarettes* (Appellate Body), para. 96.

[3] Ibid.

[4] See, for instance, *Korea—Dairy* (Appellate Body), para. 81.

exclusive.[5] However, a Panel has held that one state measure may exceptionally be covered by both the TBT and the SPS, due to its serving two (or more) different purposes.[6]

With regard to the relationship between the GATT and the SPS, SPS Article 2.4 establishes a rebuttable presumption that all measures compatible with the SPS Agreement are GATT-compatible:

> Sanitary or phytosanitary measures which conform to the relevant provisions of this Agreement shall be presumed to be in accordance with the obligations of the Members under the provisions of GATT 1994 which relate to the use of sanitary or phytosanitary measures, in particular the provisions of Article XX(b).

With regard to the relationship between the SPS and the TBT, on the one hand, and the more general GATT, on the other hand, the starting point is the General Interpretative Note to Annex 1A, which provides guidance as to how conflicts between the GATT and the other agreements dealing with trade in goods, such as the SPS and the TBT, should be resolved:

> In the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization . . . , the provision of the other Agreement shall prevail to the extent of the conflict.[7]

Accordingly, a measure falling under both the TBT and the GATT should 'normally'[8] be considered first pursuant to the more specific agreement.[9] The Appellate Body continued:

> [A]lthough the TBT Agreement is intended to "further the objectives of GATT 1994", it does so through a specialized legal regime that applies solely to a limited class of measures. For these measures, the TBT Agreement imposes obligations on Members that seem to be *different* from, and *additional* to, the obligations imposed on Members under the GATT 1994.[10]

In *US—Tuna II*, the Appellate Body found that a TBT-consistent measure could not automatically be considered GATT-consistent:

> [T]he assumption that the obligations under Article 2.1 of the *TBT Agreement* and Articles I:1 and III:4 of the GATT 1994 are substantially the same . . . is, in our view, incorrect. In fact, as we have found above, the scope and content of these provisions is not the same. Moreover, in our view, the Panel should have made additional findings under the GATT 1994 in the event that the Appellate Body were to disagree with its

[5] See, for example, *EC—Hormones (US)* (Panel), para. 8.29.
[6] *EC—Approval and Marketing of Biotech Products* (Panel), para. 7.165 *et seq.*
[7] *EC—Asbestos* (Appellate Body), para. 80.
[8] *EC—Sardines* (Panel), paras. 7.14–7.19.
[9] *EC—Asbestos* (Appellate Body), para. 77.
[10] Ibid. para. 80.

> view that the measure at issue is a "technical regulation" within the meaning of the *TBT Agreement*.[11] (Emphasis and italics in the original.)

Thus, consistency with the TBT would not per se assure compatibility with the GATT.

3. The TBT Agreement

3.1 Coverage and scope

The TBT imposes multilateral legal disciplines on two types of legal instruments and one procedure: technical regulations, standards, and conformity assessment procedures.[12] Technical regulations are defined as measures that lay down in a mandatory fashion product characteristics or related processes and production methods. Standards, in contrast, are *voluntary* measures, *approved by a recognized body*, that provide rules, guidelines, or characteristics for products or related processes and production methods.[13] Conformity assessment procedures determine whether the requirements of technical regulations or standards have been fulfilled. Whether or not the measure in question is covered by one of those three legal categories (defined in Annex 1 to the TBT and explained below) is a 'threshold issue', which 'determines whether the TBT is applicable.'[14] Note, that pursuant to Article 28 of the Vienna Convention on the Law of Treaties (VCLT), the TBT applies to all *currently applicable* technical regulations, standards, and conformity assessment procedures in force, regardless of when those measures entered into force.[15]

The TBT establishes rights and obligations for states. As most, if not all, WTO agreements it does not create rights and obligations that would be directly applicable or capable of being invoked by private actors. At first glance, an exception seems to be found in those provisions of the TBT that include 'non-governmental' bodies in the list of addressees of obligations. The TBT mentions non-governmental bodies seventeen times; for instance, the Code of Good Practice for the Preparation, Adoption and Application of Standards, annexed to the TBT provides *sub* B:

> This Code is open to acceptance by any standardizing body within the territory of a Member of the WTO, whether a central government body, a local government body, *or a non-governmental body*; to any governmental regional standardizing body one or more members of which are Members of the WTO; and to any *non-governmental* regional standardizing *body* one or more members of which are situated within the territory of a Member of the WTO (referred to in this Code collectively as "standardizing bodies" and individually as "the standardizing body"). (Emphasis added.)

Non-governmental body is defined in Annex 1.8 for the purposes of (mandatory) technical regulations as a body other than a central government body or a local

[11] *US—Tuna II* (Appellate Body), para. 405.
[12] cf. TBT Art. 1.6.
[13] cf. Annex 1 of the TBT Agreement for definitions.
[14] *EC—Sardines* (Appellate Body), para. 175; *EC—Asbestos* (Appellate Body), para. 59.
[15] *EC—Sardines* (Appellate Body), para. 216; *EC—Sardines* (Panel), para. 7.60.

government body, including a non-governmental body which has legal power to enforce a technical regulation. Hence, it is clear that the non-governmental body is far from being just another private market participant. Rather, these non-governmental standardizing bodies, while firmly rooted in the relevant industries, have been attributed para-governmental powers or at least elevated significance as recognized standardizing entities by states, for instance by using those standards in government procurement or in regulations dealing, inter alia, with consumer protection, health, road safety, aviation, or construction. While the states do not necessarily 'control' them as if they were a division of a central ministry, but—having ceded them responsibility for matters belonging to the normal exercise of state competence—are in a position to exercise influence on them. This hybrid 'non-governmental', but very government-related, form of standards governance is also reflected in international standards organizations such as the 'International Organization for Standardization' (ISO).[16]

None of that applies to corporations, even those with significant market share. Companies like Zara, Wal-Mart, Nestlé, H&M, GAP, or Carrefour may have significant market power and do establish and communicate standards to their suppliers and contractors, for example with regard to animal welfare.[17] If they pledge to use only responsibly harvested grapes, fairly produced T-shirts, humanely raised beef, or, for that matter, French cheese (and no other cheese, on the understanding of a hypothetical French supermarket chain that French cheese is superior to any other cheese),[18] and communicate this through private standards in which they detail what 'fairly produced', 'ocean-friendly', 'responsibly harvested', 'humanely raised beef', or 'French' (would Quebec cheese be 'French'?) means, this clearly would affect the market. Still, it would be outside the scope of the current standards disciplines, as these are neither 'bodies' nor exercising standardization activities sanctioned as standards by the state.

Would things change if, again hypothetically, the top five French supermarket chains pledged to sell only French cheeses as a testimony to their pride in being French? Or if the world's top five mid-price clothing chains (the GAPs, H&Ms, and Zaras of the world) agreed (without violating applicable antitrust laws) that they would only buy non-GMO cotton and textiles produced by factories in which certain working conditions apply? Again, the answer would be negative. While the market share of these corporations would be impressive indeed, they would lack the de jure or de facto conferral of what are, essentially, state competences. Rather, these corporations would choose—out of ethical conviction or because of public pressure—to carry only products meeting certain specifications. However, if these corporations were to become sanctioned standard setting bodies, or more realistically, were to help set up standard setting bodies that are recognized by state or international authorities, the legal position would, clearly, change. The legal position would also change, if the members amended the relevant law, as is being proposed by some members; the matter is regularly on the

[16] cf. <http://www.iso.org>.

[17] cf. <http://www.nestle.com/asset-library/documents/creating%20shared%20value/rural_development/nestle-commitment-farm-animal-welfare.pdf>.

[18] A statement that would clearly be unacceptable to the members producing Stilton and Gruyère cheeses.

agenda of the TBT Committee.[19] Note, that TBT Article 4.1 asks members to take such reasonable measures as may be available to them to ensure that standardizing bodies accept and comply with the Code of Good Practice.

3.1.1 Technical regulation

The term *technical regulation*[20] is defined in TBT Annex 1, paragraph 1 as a

> [d]ocument which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is *mandatory*. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method. (Emphasis added.)

Despite the characterization as a threshold issue, there has only been one case so far, in which the Appellate Body did not accept the complainant's view that the measure complained against was not a technical regulation.[21] In all decisions before, notably in the 2012 *US—Tuna II* and *US—COOL* disputes, the Appellate Body had interpreted the term technical regulation or standard very broadly indeed.[22]

3.1.1.1 Document

The term 'document' has been interpreted by the Appellate Body as covering 'a broad range of instruments or apply to a variety of measures'.[23] In *EC—Seal Products*, the Appellate Body specified that the definition in Annex 1.1 implied that only documents 'that establish or prescribe something and thus have a certain normative content' were documents for the purposes of the technical regulation.[24]

According to the Appellate Body,[25] a document must meet three *criteria* to fall within the definition of 'technical regulation' in the TBT:

(1) '*First*, the document must apply to an identifiable product or group of products. The *identifiable* product or group of products need not, however, be expressly *identified* in the document.'

(2) '*Second*, the document must lay down one or more characteristics of the product. These product characteristics may be intrinsic, or they may be related to the product. They may be prescribed or imposed in either a positive or a negative form.'

[19] cf., for example, WTO Docs. G/TBT/26, 12 November 2009, para. 26; G/TBT/13, 11 November 2003, para. 25; G/TBT/1/Rev.11, 16 December 2013, 11.

[20] For the interpretation of this term see: *US—Tuna II (Mexico)* (Panel), paras. 7.50–7.186; *US—Clove Cigarettes* (Panel), paras. 7.20–7.41.

[21] cf. *EC—Seal Products* (Appellate Body) para. 5.59, cf. also *EC—Trademarks and Geographical Indications* (Panel) para. 7.515.

[22] cf., for instance *US—Tuna II (Mexico)* (Appellate Body); *US—Clove Cigarettes* (Appellate Body); *US—COOL* (Appellate Body).

[23] *US—Tuna II (Mexico)* (Appellate Body), para. 185.

[24] *EC—Seal Products* (Appellate Body), para. 5.10.

[25] cf. also *EC—Asbestos* (Appellate Body), paras. 67–72; *EC—Sardines* (Appellate Body), paras. 175 and 176.

(3) '*Third,* compliance with the product characteristics must be mandatory'.[26]

We shall address those three criteria in turn.

3.1.1.2 Identifiable product or group of products

Whereas the standard example of a technical regulation would probably be a regulatory measure that would specifically define the pertinent product or product group, the wording of the TBT is wide enough also to permit implied coverage of a product or product group, for example 'through the "characteristic" that is the subject of the regulation'.[27] In *EC—Asbestos*, the regulation prohibited all products containing asbestos. This went beyond the mere explicit prohibition[28] and addressed all relevant products, requiring the absence of asbestos as input.[29] In *EC—Sardines*, the challenged EC regulation had explicitly determined that only *Sardina pilchardus* (in the following: A) could be sold as 'preserved sardines'. This sufficed to make all other sardines (including the fish harvested by the complainant, *Sardinops sagax* (in the following: Z)) identifiable as the ones to which the EC regulation was also applicable. Obviously, the measure had as consequence that the Peruvian 'Z' sardines could not be marketed as 'preserved sardines'. Rightly, the Appellate Body viewed the fish impliedly excluded from being named and labelled in a certain way as sufficiently identifiable.[30]

3.1.1.3 One or more product characteristics

After establishing that the 'Z' sardines were identifiable, the question arose, whether the EC Regulation 'laid down' 'characteristics of the product'. According to the Appellate Body, product characteristics may be *intrinsic*,[31] and include

> any objectively definable "features", "qualities", "attributes", or other "distinguishing mark" of a product. Such "characteristics" might relate, *inter alia*, to a product's composition, size, shape, colour, texture, hardness, tensile strength, flammability, conductivity, density, or viscosity.[32]

However, the TBT's definition of a 'technical regulation' in Annex 1.1 clearly extends the notion of characteristic beyond the product and its physical and chemical attributes to normatively prescribed attributes by including 'terminology, symbols, packaging, marking or labelling requirements'.

> In addition, according to the definition in Annex 1.1 of the *TBT Agreement*, a "technical regulation" may set forth the "applicable administrative provisions" for products which have certain "characteristics".... [T]he definition of a "technical regulation" provides that such a regulation "may also include or deal *exclusively* with terminology, symbols, packaging, marking or labelling requirements". The use here of the word "exclusively" and the disjunctive word "or" indicates that a "technical

26 *EC—Sardines* (Appellate Body), para. 176.
27 *EC—Asbestos* (Appellate Body), para. 70.
28 Which would not be recognized as a technical regulation, *EC—Asbestos* (Appellate Body), para. 72.
29 Ibid. para. 74.
30 *EC—Sardines* (Appellate Body), para. 186.
31 Ibid. para. 176.
32 *EC—Asbestos* (Appellate Body), para. 67.

> regulation" may be confined to laying down only one or a few "product characteristics".[33] (Emphasis and italics in the original.)

EC—Sardines dealt with that latter type of characteristic: the fish's quality may be second to none, but whether it may be labelled and sold under the name which consumers will look for, determines the commercial success in ways similar to the product quality. Thus, the Appellate Body viewed the EC regulation as determining characteristics.[34]

> We do not find it necessary, in this case, to decide whether the definition of "technical regulation" in the TBT makes a distinction between "naming" and labelling. . . . We are of the view that this requirement—to be prepared exclusively from fish of the species *Sardina pilchardus*—is a product characteristic "intrinsic to" preserved sardines that is laid down by the EC Regulation. . . .
>
> [A]s we said in *EC—Asbestos*, a "means of identification" *is* a product characteristic. A name clearly identifies a product . . .[35] (Emphasis and italics in the original.)

3.1.1.4 Compliance with the product characteristics must be mandatory

A recent summary of what defines 'mandatory' can be found in *EC—Seal Products*, where the term is described as prescribing

> rules concerning the placing on the market of seal products "in a binding or compulsory fashion".[36] Specifically, the EU Seal Regime prohibits seal products from the EU market, except in cases where they meet [certain] conditions . . .[37]

The measure in question may impose the mandatory requirement in a negative or a positive form, and implicitly or explicitly. An example for positive and explicit determination would be a regulation that prescribes the following: 'The canned fish product *Preserved Sardines* may only contain A-sardines'; negatively and impliedly, it prohibits that *Preserved Sardines* contain Z-sardines.

In *US—Tuna II*, a US measure that defined the conditions for the use of a *voluntary* label was held to be a technical regulation due to its mandatory effects:

> [T]he US measure not only sets out certain conditions for the use of a label, but, in addition, *it enforces a prohibition against the use of any other label* containing the terms "dolphin-safe", "dolphins", "porpoises", or "marine mammals" on a tuna product that does not comply with the requirements set out in the measure. Moreover, the enforcement of the US measure does not require proving that a given conduct is deceptive under a law against deceptive practices. Rather, . . . the measure at issue establishes a single definition of "dolphin-safe" and *treats any statement on a tuna product regarding "dolphin-safety" that does not meet the conditions of the measure as a deceptive practice or act*. (Emphasis added.)[38]

[33] Ibid. para. 67. [34] *EC—Sardines* (Appellate Body), paras. 190–1.

[35] Ibid. paras. 190–1; see also *EC—Trademarks and Geographical Indications (Australia)* (Panel), para. 7.449: '[T]he label on a product *is* a product characteristic'.

[36] Footnote 894 in the original, referring to *EC—Asbestos* (Appellate Body), para. 68.

[37] *EC—Seal Products* (Appellate Body), para. 5.22.

[38] *US—Tuna II* (Appellate Body), para. 195.

The Appellate Body rejected the position that compliance with a labelling requirement was 'mandatory' only if it was a *conditio sine qua non* for placing the product on the market.

> [W]hile it is possible to sell tuna products without a "dolphin-safe" label in the United States, any "producer, importer, exporter, distributor or seller" of tuna products must comply with the measure at issue in order to make any "dolphin-safe" claim.[39]

Similarly, in *EC—Sardines*, the prohibition to label the 'Z' sardine as *preserved sardine*, was not a prohibition to put the product in question on the market. Thus,

> the mere fact that it is legally permissible to sell a product on the market without using a particular label is not determinative when examining whether a measure is a "technical regulation" within the meaning of Annex 1.1.[40]

3.1.1.5 Holistic analysis

The three-tiered test just presented[41] has been used by the Appellate Body in all TBT disputes decided so far, sometimes in a different order. Especially in the context of determining whether the prohibition of a product (in other words: a product ban) was a technical regulation, the Appellate Body used broad language to allow an appropriate evaluation of the specific facts of the case. In *Asbestos*, it stated:

> [T]he proper legal character of the measure at issue cannot be determined unless the measure is examined as a whole. Article 1 of the Decree contains broad, general prohibitions on asbestos and products containing asbestos. However, the scope and generality of those prohibitions can only be understood in light of the exceptions to it which, albeit for a limited period, *permit*, *inter alia*, the use of certain products containing asbestos and, principally, products containing chrysotile asbestos fibres. The measure is, therefore, *not* a *total* prohibition on asbestos fibres, because it also includes provisions that *permit*, for a limited duration, the use of asbestos in certain situations.[42] (Emphasis and italics in the original.)

Whereas a technical regulation can, not unlike a ban, lead to the exclusion of a product from the market, it differs from the latter in that it regulates and determines the conditions pursuant to which market access is given.

In *US—Tuna* II, the Appellate Body, undertook to examine whether the measure at hand was a voluntary standard or rather a mandatory technical regulation:

> [W]hether a particular measure constitutes a technical regulation must be made in the light of the characteristics of the measure at issue and the circumstances of the case. In some cases, this may be a relatively straightforward exercise. In others, the task of the panel may be more complex. Certain features exhibited by a measure may be common to both technical regulations falling within the scope of Article 2 of the *TBT Agreement* and, for example, standards falling under Article 4 of that Agreement. Both types of measure could, for instance, contain conditions that must be met in order to use a

[39] Ibid. para. 196. [40] Ibid. para. 198.
[41] *EC—Sardines* (Appellate Body), para. 176.
[42] *EC—Asbestos* (Appellate Body), para. 64.

label. In both cases, those conditions could be "compulsory" or "binding" and "enforceable". Such characteristics, taken alone, cannot therefore be dispositive of the proper legal characterization of the measure under the *TBT Agreement*. Instead, it will be necessary to consider additional characteristics of the measure in order to determine the disciplines to which it is subject under that Agreement. This exercise may involve considering whether the measure consists of a law or a regulation enacted by a WTO Member, whether it prescribes or prohibits particular conduct, whether it sets out specific requirements that constitute the sole means of addressing a particular matter, and the nature of the matter addressed by the measure.[43]

The quoted passages above, but also the passages from *EC—Asbestos* and *EC—Sardines*[44] had a very specific thrust, and were integrated in the three-tier analysis. However, in *EC—Seal Products* the Appellate Body chose to make a more general statement, introducing the terms 'design' and 'operation' of the measure in question, terms previously used in other contexts:

First, the Appellate Body has emphasized that a determination of whether a measure constitutes a technical regulation "must be made in the light of the characteristics of the measure at issue and the circumstances of the case". As the Appellate Body has explained, this analysis should give particular weight to the "integral and essential" aspects of the measure. In determining whether a measure is a technical regulation, a panel must therefore carefully *examine the design and operation of the measure* while seeking to identify its "integral and essential" aspects. It is these features of the measure that are to be accorded the most weight for purposes of characterizing the measure, and, thereby, for determining whether it is subject to the disciplines of the TBT Agreement. *The ultimate conclusion as to the legal characterization of the measure must be made in respect of, and having considered, the measure as a whole* [emphasis added].

Second, the issue of how best to characterize a measure at issue which comprises several different elements is one that arises in many disputes. The question is of particular significance in cases where the inclusion or exclusion of certain elements in the definition of the measure can affect the legal characterization, or substantive analysis of the measure. A panel may, in some cases, find it appropriate to treat several domestic legal instruments together as a single measure in order to facilitate its analysis of that measure in the light of the claims raised or defences invoked.[45] Conversely, there may be instances where a panel may choose to consider different elements set out in a single legal instrument as different "measures", for purposes of its analysis.[46]

[43] *US—Tuna II* (Appellate Body), para. 188, referring, inter alia, to *EC—Asbestos* (Appellate Body), para. 64; *EC—Sardines* (Appellate Body), paras. 192 and 193; and *China—Auto Parts* (Appellate Body), para. 171.

[44] *EC—Sardines* (Appellate Body), para. 199.

[45] [Footnote 887 in the original:] For example, in *EC—Bananas III*, the EC Banana Regime comprised the Council Regulation (EEC) 404/931 'and the subsequent EC legislation, regulations and administrative measures, including those reflecting the provisions of the Framework Agreement on Bananas, which implemented, supplemented and amended that regime' (Panel reports, *EC—Bananas III*, para. 1.1). Treating multiple legal instruments as a single measure does not preclude a complainant from challenging different aspects of such a measure under different provisions of the WTO covered agreements.

[46] *EC—Seal Products* (Appellate Body), paras. 5.19, 5.20; referring, inter alia, to *Brazil—Retreaded Tyres* (Appellate Body), paras. 126, 127.

As a consequence of this holistic effort, the Appellate Body rejected for the first time the claim of a complainant that a measure with mandatory effect on certain products was a technical regulation; possibly, this constitutes a reaction to criticism that the Appellate Body had not used the three-tiered test as a filter to avoid an overly broad scope of the TBT.

3.1.1.6 Processes and production methods

Importantly, though, *EC—Seal Products* did not develop the notion of 'processes and production methods' (PPMs) and pertinent administrative provisions.[47] It will be recalled that the term *technical regulation* covers a document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory.

Whether and to what extent PPMs are covered by the TBT has been the subject of significant scholarly attention. PPMs are commonly categorized in two different types:[48]

- Product-related PPMs are based on the physical characteristics of a product and are supposed to ensure the best use of the product itself. Given the wording of Annex 1.1, there is no reason to assume that they could not be covered by a technical regulation.
- Non-product-related PPMs concern the production process and *not* the product as such and its intrinsic characteristics. Non-product-related PPMs prevent consumers to finance public or private behaviour or conditions that are not reconcilable with political choices of the importing state: they tend to serve the advancement of political goals, sometimes of the highest ethical order. An example would be measures that render the marketing of products produced under violatation of peremptory norms of international law difficult or impossible. A football produced under duress by children of political prisoners in a concentration camp is as adequate as any other football, but the conditions of its production are not.[49] Whether non-product related PPMs are covered by the TBT—and thus subject to the substantive disciplines of TBT Article 2 *et seq*. is disputed.[50]

[47] *EC—Seal Products* (Appellate Body), para. 5.47 *et seq*.

[48] Reinhard Quick and Reinhard Lau, 'Environmentally Motivated Tax Distinctions and WTO Law: The European Commission's Green Paper on Integrated Product Policy in Light of the "Like Product-" and "PPM-" Debates' (2003) *Journal of International Economic Law* 6, 419–58; Steve Charnovitz, 'The Law of Environmental "PPMs" in the WTO: Debunking the Myth of Illegality' (2000) *Yale Journal of International Law* 27, 59, 65 *et seq*.

[49] Similarly, shrimps caught by vessels equipped with turtle excluder devices (TEDs) are similar to shrimp (possibly from the same catchment area) by boats without such turtle-saving features; cf. *US—Shrimp* (Appellate Body), para. 2 *et seq*.

[50] See, for example, Manoj Joshi, 'Are Eco-Labels Consistent with WTO Agreements?' (2004) *Journal of World Trade* 38, 69–92. The Panels in *Tuna—Dolphin I* and *Tuna—Dolphin II* found that such non-product-related PPM regulations were not covered under GATT Arts. I and III, and instead violated GATT Art. XI, because Arts. I and III are concerned only with regulations on 'products'; cf. GATT Panel report, *US—Restrictions on Imports of Tuna*, DS21/R, 3 September 1991, unadopted, B.I.S.D. 39S/155; *US—Tuna II* (Panel) left Mexico's claims under Art. I:1 and III:4 unaddressed due to judicial economy, and focused on the TBT. *US—Tuna II* (Appellate Body), para. 406 overturned this exercise of judicial economy on appeal,

The second sentence of TBT Annex 1.1 specifies that the document 'may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, *process or production method*'. (Emphasis added.) Does the second sentence indicate that at least with regard to labelling and marking, in practice a very important issue, the drafters had given up the product-centred view? The negotiating history seems inconclusive: in order to exclude non-product-related PPMs, Mexico proposed to add the word 'their' ('their related processes and production methods') to the definition of a technical regulation.[51] This proposal was accepted.[52] However, neither the already presented second sentence of Annex 1.1, nor the pertinent explanatory note to Annex 1.2 contains the terms 'their' or even 'related'.[53]

The jurisprudence of the Appellate Body and the positioning of the WTO membership, in the above-mentioned disputes and elsewhere, is not conclusive so far, although arguably bending towards a recognition of non-product-related PPMs. Already in *US—Shrimp*, the measure at hand was a non-product-related PPM labelling obligation.[54] The Appellate Body found it, in principle, to be justifiable under Article XX GATT, thus not taking up the opportunity to outlaw such a non-product-related trade 'impediment'. In *US—Tuna II*, and arguably in *US—COOL*, the measures at hand were non-product-related PPMs; nevertheless the US sophisticated legal team of the US Trade Representative (USTR) at no point based objections regarding the application of the TBT on that circumstance. The practice of the TBT Committee is equally indicative of a tendency towards an inclusion of non-product-related PPMs: All mandatory labelling requirements have to be notified, regardless of the information they share with the consumer.[55]

but did not complete the legal analysis. Thus, the *specific* guidance of a relevant Appellate Body report is missing.

[51] cf. WTO Doc. WT/CTE/W/10, G/TBT/W/11, Committee on Trade and Environment/Committee on Technical Barriers to Trade, Negotiating History of the Coverage of the Agreement on Technical Barriers to Trade with Regard to Labelling Requirements, Voluntary Standards, and Processes And Production Methods Unrelated to Product Characteristics, Note by the Secretariat, paras. 146–7.

[52] Ibid. paras. 148–51; as to the proposal, ibid. paras. 146–7.

[53] Annex 1.2 reads: '2. *Standard:* Document approved by a recognized body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory. *It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method*' (emphasis added). Note that this second sentence can also be found in Annex 1.1. In the 'Explanatory note' to Annex 1.2 the drafters included the sentence: 'This Agreement deals only with technical regulations, standards and conformity assessment procedures related to products or processes and production methods.' Thus, again no explicit exclusion of non-product-related PPMs can be found.

[54] *US—Shrimp* (Appellate Body), para. 3 *et seq.*

[55] WTO Doc. G/TBT/1 Rev. 11 (16 December 2013), Committee on Technical Barriers to Trade, Decisions and Recommendations adopted by the Committee since 1 January 1995, Note by the Secretariat, sub 4.3.1.4 (22): 'In 1995, with the purpose of clarifying the coverage of the Agreement with respect to labelling requirements, the Committee took the following decision [footnote 50 in the original: G/TBT/M/2, 4 October 1995, para. 5; G/TBT/W/2/Rev.1, 21 June 1995, 11.] In conformity with Article 2.9 of the Agreement, Members are obliged to notify all mandatory labelling requirements that are not based substantially on a relevant international standard and that may have a significant effect on the trade of other Members. *That obligation is not dependent upon the kind of information which is provided on the label, whether it is in the nature of a technical specification or not*'. (Emphasis added.)

In *EC—Seals*, the question to what extent the extraterritorial regulation regarding the conditions of 'harvesting' seals were covered by the definition of technical regulation had not been explored at the Panel level and were thus left to be decided on another day.[56]

3.1.2 Standards

In addition to technical regulations, the TBT regulates standards and conformity assessments. Standards are defined in Annex 1.2 as a

> [d]ocument approved by a *recognized* body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method. (Emphasis added.)[57]

Standards are by definition voluntary, meaning that, selling a non-conforming product is legally possible and would not trigger criminal or other responsibility. As discussed earlier with regard to the Appellate Body's *US—Tuna II* report, the question whether the criteria laid down by a relevant document are mandatory or rather voluntary is not always easy.

Standards, not unlike brands, convey—often through labels—information. For instance, a product meeting the German DIN standards may benefit from the positive connotation of the information 'Made in Germany'. It also means that it should work perfectly with other products that depend on inter-connectivity, provided these products meet the relevant standard (think of linking computers with printers or other peripheral items). Businesses may prefer to use products that meet the standards of certain standardization bodies—for instance DIN—not least because they expect consumers to look out for these standards. To make a long story short: despite their non-mandatory nature, standards are of supreme commercial importance. Their increased importance stems not least from their being elaborated by state agencies or non-governmental bodies recognized in their standardization function by the state. Thus, the TBT addresses them specifically in TBT Article 4 and the annexed 'Code of Good Practice for the Preparation, Adoption and Application of Standards', but also subjects them to some general obligations.

As indicated above, not 'any' standard setting body will do: Rather they must be recognized. That is self-evident when a standard setting body is set up by national legislation, such as *Standards New Zealand* or the *South African Bureau of Standards*.[58] When, however, it takes the form of a privately owned entity, composed of industry

[56] *EC—Seal Products* (Appellate Body), para. 5.61 *et seq.*

[57] An 'Explanatory Note' explains further: 'The terms as defined in ISO/IEC Guide 2 cover products, processes and services. This Agreement deals only with technical regulations, standards and conformity assessment procedures related to products or processes and production methods. Standards as defined by ISO/IEC Guide 2 may be mandatory or voluntary. For the purpose of this Agreement standards are defined as voluntary and technical regulations as mandatory documents. Standards prepared by the international standardization community are based on consensus. This Agreement covers also documents that are not based on consensus.'

[58] <http://www.iso.org/iso/home/about/iso_members/iso_member_body.htm?member_id=1998>.

representatives, public authorities, commerce, and research organizations, for example, the Deutsches Institut für Normung (DIN), it needs to be recognized by the addressee of TBT obligations. This recognition may be found in the use of the standards of that body, but also be deducted from the composition of share holders in case of organizations set up as private corporations, or from agreements, practices, or other measures.

Pursuant to TBT Article 4.1, all *central government standardizing bodies* of WTO members are bound by the disciplines laid down in the Code of Good Practice annexed (Annex 3) to the TBT. Compliance with the Code of Good Practice amounts *ipso facto* to compliance with the principles of the TBT. With this regard TBT Article 4.2 is pertinent:

> Standardizing bodies that have accepted and are complying with the Code of Good Practice shall be acknowledged by the Members as complying with the principles of this Agreement.

Paragraph D of the Code of Good Practice reads:

> In respect of standards, the standardizing body shall accord treatment to products originating in the territory of any other Member of the WTO no less favourable than that accorded to like products of national origin *and* to like products originating in any other country. (Emphasis added.)

Irrespective of domestic production, standardizing bodies are thus subject to a national treatment (NT) and a most favoured nation (MFN) obligation. The Code of Good Practice restates, for the purposes of non-mandatory standards, many obligations that also apply to technical regulations (discussed below), such as:

- the obligation that standards are not prepared, adopted, or applied with a view to, or with the effect of, creating unnecessary obstacles to international trade (paragraph E);
- the obligation to use international standards, except where this would be ineffective or inappropriate (paragraph F);
- the obligation to contribute to the elaboration of international standards (paragraph G) and to avoid duplication between domestic, as well as between domestic and international standard setting bodies (paragraph H);
- the obligation to use performance-based standards (paragraph I);
- the obligation to publish work programmes and notify standards to the ISO/IEC Information Centre in Geneva (paragraph J);
- the obligation to allow a period of at least sixty days for the submission of comments on the draft standard by interested parties within the territory of a member of the WTO (paragraph L);
- and many further obligations ensuring participation in and information about standards and standard-related activities.

3.1.3 Conformity assessment

Lastly, the TBT also applies to 'conformity assessment procedures', which are defined in Annex 1.3 as '[a]ny procedure used, directly or indirectly, to determine that relevant

requirements in technical regulations or standards are fulfilled'. In an explanatory note, the TBT specifies that these include 'procedures for sampling, testing and inspection; evaluation, verification and assurance of conformity; registration, accreditation and approval as well as their combinations.' Through conformity assessment, foreign regulatory measures may be accepted as equivalent to domestic technical regulations and/or standards. In other words, they serve to evaluate a product according to specified domestic benchmarks, laid down in technical regulations and standards.

Pursuant to the TBT, WTO members are obliged to grant foreign suppliers access to their facilities, under the same conditions as the ones extended to domestic producers, in order for their products to conform with the relevant domestic technical regulations or standards assessed (TBT Article 5.1.1). Conformity assessment procedures must respect the necessity principle, in the sense that they should not be more trade-restrictive than is required to achieve their objective (TBT Article 5.1.2), must be published (TBT Article 5.8), and further detailed to interested parties (TBT Articles 5.2 and 5.6). Although there is no general obligation to accept other members' conformity assessment procedures, members 'shall ensure' that results of foreign conformity assessment procedures are accepted, 'provided they are satisfied that those procedures offer an assurance of conformity with applicable technical regulations or standards equivalent to their own procedures'; this may require 'prior consultations . . . in order to arrive at a mutually satisfactory understanding' (TBT Article 6.1). WTO members are encouraged to sign Mutual Recognition Agreements (MRAs) in the field of conformity assessment procedures (TBT Article 6.3) and to participate in the work of international bodies aiming at harmonizing conformity assessment procedures (TBT Article 5.5). With regard to standardizing bodies at the sub-central government level, WTO members undertake more limited obligations.[59]

3.2 Substantive provisions of the TBT Agreement with regard to technical regulations

3.2.1 Non-discrimination

In its Article 2.1, the TBT contains a specific non-discrimination obligation, which encompasses both national treatment and an MFN obligation, according to which

> Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country.

Thus, states may not use their (mandatory) technical regulations in order to discriminate between like products from different WTO members (MFN principle) and with regard to domestically produced 'like products' (NT principle).

[59] TBT Art. 7.

3.2.1.1 Like products

In *US—Clove Cigarettes*, the Appellate Body stated:

> The interpretation of the concept of "likeness" in Article 2.1 has to be based on the text of that provision as read in the context of the *TBT Agreement* and of Article III:4 of the GATT 1994, which also contains a similarly worded national treatment obligation that applies to laws, regulations, and requirements including technical regulations. In the light of this context and of the object and purpose of the *TBT Agreement*, as expressed in its preamble, we consider that the determination of likeness under Article 2.1 of the *TBT Agreement*, as well as under Article III:4 of the GATT 1994, is a determination about the nature and extent of a competitive relationship between and among the products at issue.[60]

Therefore, the modified border tax adjustment test of a product's physical characteristics, end-uses, consumer tastes and habits, and regulatory (in particular: tariff) classification will have to be applied.[61]

The Appellate Body rejected the Panel's proposal that the declared legitimate public health objective of the measure, namely, reducing youth smoking, 'must permeate and inform [its] *likeness* analysis':[62]

> [M]easures often pursue a multiplicity of objectives, which are not always easily discernible from the text or even from the design, architecture, and structure of the measure. Determining likeness on the basis of the regulatory objectives of the measure, rather than on the products' competitive relationship, would require the identification of all the relevant objectives of a measure, as well as an assessment of which objectives among others are relevant or should prevail in determining whether the products are like. It seems to us that it would not always be possible for a complainant or a panel to identify all the objectives of a measure and/or be in a position to determine which among multiple objectives are relevant to the determination of whether two products are like, or not.[63]

However, 'regulatory concerns underlying technical regulations may play a role in the determination of likeness', provided 'they are relevant to the examination of certain "likeness" criteria and are reflected in the products' competitive relationship'.[64] In the case at hand, the Appellate Body was satisfied that there was sufficient evidence to show that *imported* clove and *domestic* menthol cigarettes were indeed competing for a significant consumer group, young smokers.

3.2.1.2 Less favourable treatment

Pursuant to TBT Article 2.1, like imported products have to receive treatment no less favourable than that accorded to like domestic products or to like products originating

[60] *US—Clove Cigarettes* (Appellate Body), para. 120.

[61] *Japan—Alcoholic Beverages II* (Appellate Body), 20–2; *Philippines—Distilled Spirits* (Appellate Body), para. 113 *et seq.*

[62] *US—Clove Cigarettes* (Panel), para. 7.116 (emphasis added).

[63] *US—Clove Cigarettes* (Appellate Body), para. 113.

[64] Ibid. para. 120.

in any other country. Had the Appellate Body continued to apply in an analogous fashion its GATT Article III precedents, it would have analysed whether a technical regulation had caused a detrimental impact on competitive opportunities for the group of imported vis-à-vis the group of domestic like products. As the TBT does not contain a general exception similar to that in GATT Article XX, this would have led to a much stricter regime of non-discrimination than the one established by the GATT. In *US—Clove Cigarettes*, the Appellate Body avoided this result by reading a *rule of reason* into TBT Article 2.1. Highlighting that the *raison d'être* of technical regulations was to 'establish distinctions between products according to their characteristics or their related processes and production methods', the seemingly clear wording of the provision could in the Appellate Body's view, not be understood to 'mean that *any* distinction, in particular those that are based *exclusively* on particular product characteristics or their related processes and production methods, would *per se* accord less favourable treatment within the meaning of Article 2.1' (emphasis in the original).[65] Rather, it came to the following conclusion:

> [T]he context and object and purpose of the *TBT Agreement* weigh in favour of reading the "treatment no less favourable" requirement of Article 2.1 as prohibiting both *de jure* and *de facto* discrimination against imported products, while at the same time permitting detrimental impact on competitive opportunities for imports that stems *exclusively from legitimate regulatory distinctions*. (Emphasis added.)[66]

The Appellate Body came to that result by immediately turning to TBT Article 2.2 as relevant context. TBT Article 2.2 reads:

> Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create.

According to the Appellate Body, TBT Article 2.2 made clear that the TBT Agreement does not rule out categorically *any* obstacles to international trade. Rather, only those obstacles that are 'found to be "unnecessary", that is, "more trade-restrictive than necessary to fulfil a legitimate objective"' are comprehensively prohibited. To argue otherwise would lead, in the Appellate Body's view, to an untenable result: '[I]f *any* obstacle to international trade would be sufficient to establish a violation of Article 2.1, Article 2.2 would be deprived of its *effet utile*.'[67] The Appellate Body goes on:

> This interpretation of Article 2.1 is buttressed by the sixth recital of the preamble of the *TBT Agreement*, [which] . . . expressly acknowledges that Members may take measures necessary for, *inter alia*, the protection of human life or health, provided that such measures "are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination" or a "disguised restriction on international

[65] Ibid. para. 169. [66] Ibid. para. 175. [67] Ibid. para. 171.

> trade" and are "otherwise in accordance with the provisions of this Agreement"... [emphasis in the original]
>
> Finally, ... the object and purpose of the *TBT Agreement* is to strike a balance between, on the one hand, the objective of trade liberalization and, on the other hand, Members' right to regulate. This object and purpose therefore suggests that *Article 2.1 should not be interpreted as prohibiting any detrimental impact on competitive opportunities for imports in cases where such detrimental impact on imports stems exclusively from legitimate regulatory distinctions*. (Emphasis added.)[68]

Hence, *US—Clove Cigarettes* stands for the proposition that any complaint based on TBT Article 2.1 needs to pass a two-tiered test. The *first* one is to determine

> where the technical regulation at issue does not *de jure* discriminate against imports, the existence of a detrimental impact on competitive opportunities for the group of imported vis-à-vis the group of domestic like products.[69]

If that question is answered in the affirmative, this—unlike the situation in GATT Article III:4—'is not dispositive of less favourable treatment under [TBT] Article 2.1'. This statement merits attention: As WTO law stands, the distortion of competitive relationships is not per se incompatible with TBT Article 2.1. Rather, a Panel must, in what is the *second* part of the TBT Article 2.1 test, proceed to

> further analyze whether the detrimental impact on imports stems *exclusively from a legitimate regulatory distinction* rather than reflecting discrimination against the group of imported products. In making this determination, a panel must carefully scrutinize the particular circumstances of the case, that is, the design, architecture, revealing structure, operation, and application of the technical regulation at issue, and, *in particular*, whether that technical regulation is even-handed, in order to determine whether it discriminates against the group of imported products. (Emphasis added.)[70]

Clearly, the notion of discrimination is at the centre of this jurisprudence. However, the extent of the parallelism between the (impliedly permitted) 'legitimate regulatory distinction' pursuant to TBT Article 2.1, on the one hand, and the 'legitimate objectives' pursuant to TBT Article 2.2, on the other hand, is not yet developed. Concepts such as 'even-handedness' seem to draw on experiences in other jurisdiction, including US interstate commerce clause law, and EU free movement of goods law. When the Appellate Body states that

> not every instance of a detrimental impact amounts to the less favourable treatment of imports that is prohibited under that provision. Rather, some technical regulations that have a *de facto* detrimental impact on imports may not be inconsistent with Article 2.1 when such impact stems exclusively from a legitimate regulatory distinction. In contrast, where a regulatory distinction is not designed and applied in an even-handed manner—because, for example, it is designed or applied in a manner that constitutes a means of arbitrary or unjustifiable discrimination—that distinction cannot be considered "legitimate", and thus the detrimental impact will reflect

[68] Ibid. paras. 172–4. [69] Ibid. para. 182. [70] Ibid.

> discrimination prohibited under Article 2.1. In assessing even-handedness, a panel must "carefully scrutinize the particular circumstances of the case, that is, the design, architecture, revealing structure, operation, and application of the technical regulation at issue",[71]

one cannot fail to recall the ECJ jurisprudence eliminating certain state regulations from the scope of TFEU Article 34, provided they do not discriminate, in law or in fact, against foreign goods.[72] This may be indicative of the future direction in the Appellate Body's case law. Note that the term 'legitimate regulatory distinction', developed in *US—Clove Cigarettes* and without a model in either the GATT or TBT, has become a feature of the pertinent jurisprudence.[73]

The Appellate Body's new test for TBT Article 2.1 avoids the problem of an overly restrictive reading of the TBT. Whereas the wording of the TBT would not necessarily reveal this at first sight, it would seem to be a fair assessment that the drafters of the TBT did not want to completely deviate from the balance between trade-liberalizing disciplines and remaining significant policy space for the members.

> The balance set out in the preamble of the *TBT Agreement* between, on the one hand, the desire to avoid creating unnecessary obstacles to international trade and, on the other hand, the recognition of Members' right to regulate, is not, in principle, different from the balance set out in the GATT 1994, where obligations such as national treatment in Article III are qualified by the general exceptions provision of Article XX.[74]

In this light, the omission of a general exception such as Article XX had to be compensated by a dogmatically tenable contextual and teleological interpretation.

3.2.2 'Technical regulations shall not be more trade-restrictive than necessary' (TBT Article 2.2)

The ambit of the *non-discrimination* obligation in TBT Article 2.1 is strengthened by TBT Article 2.2, its immediate context, which provides that *technical regulations* shall not be

> prepared, adopted or applied with a view or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create .... In assessing such risks, relevant elements of consideration are, *inter alia*: available scientific and technical information related processing technology or intended end-uses of products.

[71] *US—COOL* (Appellate Body), para. 271, quoting, inter alia, *US—Clove Cigarettes* (Appellate Body), para. 182; *US—Tuna II (Mexico)* (Appellate Body), para. 216.

[72] Cases C-267 and C-268/91 *Criminal Proceedings against Bernard Keck and Daniel Mithouard* [1993] ECR I-6097.

[73] See, for example, *US—COOL* (Appellate Body), para. 271, reprinted in the paragraph above.

[74] *US—Clove Cigarettes* (Appellate Body), para. 96.

Furthermore, TBT Article 2.2 gives the following examples of legitimate regulatory objectives as: 'national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment'.

3.2.2.1 'First, a "legitimate objective" . . .'

As noted above, TBT Article 2.2 gives examples of legitimate objectives.[75] The difficulty for the interpreter begins when an objective is not listed: While the TBT uses the words '*inter alia*' before listing the examples, making clear that the list is not a closed one, the question arises under what conditions an objective can be viewed as legitimate. According to the Appellate Body, 'objectives expressly listed provide a reference point for which other objectives that may be considered to be legitimate';[76] guidance should also be provided by a comparative analysis 'whether the identified objective is reflected in other provisions of the covered agreements'.[77] For instance, the sixth and seventh recitals of the TBT refer to several objectives, which partially overlap with the objectives listed in Article 2.2 TBT.[78] Hence, in contrast to GATT Article XX,[79] TBT Article 2.2 establishes an open-ended list of objectives, allowing members, in principle, to pursue legitimate objectives through the use of technical regulations, for instance labels.

In *US—Tuna II*, the Appellate Body accepted the Panel's evaluation[80] that the US measure had the legitimate twin objectives of protecting dolphins and consumers, the latter by informing them about the impact of the methods used for fishing on the high seas, that is, the undesirable dolphin by-catch.[81] Note that this may permit WTO members to use domestic market-related legislation to pursue their 'legitimate objectives' extraterritorially.[82]

In *US—COOL*, the Appellate Body accepted the

> legitimacy of the objective pursued by the United States through the COOL measure, namely, to provide consumers with information on the countries in which the livestock from which the meat they purchase is produced were born, raised, and slaughtered. . . . [The] arguments and evidence submitted by [Canada] failed to persuade the Panel that providing consumers with information on origin, as defined under the COOL measure, is *not* a legitimate objective [emphasis in the original].[83]

Canada had argued that the objective of providing consumers with information was not shared by any WTO agreement; relying on 'other WTO members' labelling measures

[75] See *US—COOL* (Appellate Body), para. 370; *US—Tuna II (Mexico) (*Appellate Body), para. 313.
[76] *US—Tuna II (Mexico) (*Appellate Body), para. 313.
[77] *US—COOL* (Appellate Body), para. 372.
[78] Ibid. para. 370, referring to *US—Tuna II (Mexico)* (Appellate Body), para. 313.
[79] cf. also GATS Art. XIV.
[80] *US—Tuna II (Mexico)* (Panel), para. 7.437 *et seq*.
[81] *US—Tuna II (Mexico)* (Appellate Body), para. 337.
[82] cf. Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization*, 3rd edn. (Cambridge University Press, 2013) 551 *et seq*; *US—Tuna II* (Panel), paras. 5.31–5.32; see *US—Shrimp* (Appellate Body), para. 121. The US adapted its measures to the Appellate Body's satisfaction and managed to justify its non-product-related PPM under Art. XX(g). See *US—Shrimp (Article 21.5—Malaysia)* (Appellate Body), para. 153.
[83] *US—COOL* (Appellate Body), para. 453.

that "purport" to provide consumer information on the origin of food products' and claiming to protect consumers should not suffice for a 'legitimate objective'.[84] The Appellate Body would have none of that:

> [T]he provision of information to consumers on origin bears some relation to the objective of prevention of deceptive practices reflected in both Article 2.2 itself and Article XX(d) of the GATT 1994, insofar as consumers could be deceived as to the origin of products if labelling is inaccurate or misleading.... [S]upport for the legitimate nature of the objective of providing information to consumers on origin is also found elsewhere in the covered agreements, in particular in Article IX of the GATT 1994. This provision, entitled "Marks of Origin", expressly recognizes the right of WTO Members to require that imported products carry a mark of origin.... [and] indicate[s] that requiring origin labelling for imported goods is, at least in some circumstances and for some definitions of "origin", considered under WTO law to be a permissible means of regulating trade in goods.[85]

Given that the parties had not discussed the relevance of GATT Article IX, it seems that the Appellate Body is prepared to endorse any *reasonable* regulatory interest that states use when balancing trade interests against other legitimate political choices, such as 'to reduce youth smoking'.[86]

How then does one determine the 'aim or target that is lawful, justifiable, or proper'?[87]

> In identifying the objective pursued by a Member, a panel should take into account that Member's articulation of what objective(s) it pursues through its measure. However, a panel is not bound by a Member's characterizations of such objective(s). Indeed, in order to make an *objective and independent assessment of the objective that a Member seeks to achieve, the panel must take account of all the evidence put before it in this regard, including "the texts of statutes, legislative history, and other evidence regarding the structure and operation" of the technical regulation at issue*.[88]

Not surprisingly, the parties in *US—Tuna II (Mexico)*, *US—COOL*, and *US—Clove Cigarettes* discussed with *gusto* the allegedly 'true objectives' of the pertinent technical regulations. Obviously, the determination of the relevant objective may and typically will affect whether the measure is pursuing a legitimate objective or not. The Appellate Body emphasized that the condition that the measure is not a means *of arbitrary or unjustifiable discrimination or a disguised restriction on trade* does not apply to the *objective* but rather only to the *effect of the measure at hand*.[89]

[84] *US—COOL* (Appellate Body), para. 435, referring to Canada's other appellant's submission, paras. 62, 63.

[85] Ibid. para. 445.

[86] *US—Clove Cigarettes* (Appellate Body), para. 225.

[87] *US—Tuna II (Mexico)* (Appellate Body), para. 313 (referring to William Trumble, Angus Stevenson, eds., *Shorter Oxford English Dictionary*, 6th edn. (Oxford University Press, 2007) Vol. 1, 1577; and Vol. 2, 1970).

[88] *US—COOL* (Appellate Body), para. 371 (emphasis added); *US—COOL* refers to *US—Tuna II (Mexico)* (Appellate Body), para. 314.

[89] *US—Tuna II (Mexico)* (Appellate Body), para. 339.

3.2.2.2 Does the technical regulation 'fulfil a legitimate objective'?

In *US—Tuna II (Mexico)*, the Appellate Body highlighted that the phrase 'fulfil a legitimate objective' in TBT Article 2.2, when read in isolation, could be understood to require *complete* achievement.[90] This, however, would absurdly reduce the policy space of members: only *successful* political choices could then benefit from the balancing provision of TBT Article 2.2. That, in turn, would mean that policy makers would be drastically limited in their freedom to tackle societal or environmental problems in good faith by making informed decisions targeting an identified cause of the situation, albeit *without guaranteeing* to solve the problem once and for all.

In light of such an untenable result, the Appellate Body rightly viewed the notion of fulfilment as being 'concerned with the *degree* of contribution that the technical regulation makes towards the achievement of the legitimate objective'.[91] The Appellate Body found contextual support for this interpretation again in the sixth recital of the TBT Preamble, which provides that a member shall not be prevented from taking measures necessary to achieve its legitimate objectives 'at the levels it considers appropriate':[92]

> The degree or level of contribution of a technical regulation to its objective is not an abstract concept, but rather something that is *revealed through the measure itself*. In preparing, adopting, and applying a measure in order to pursue a legitimate objective, a WTO Member articulates, either implicitly or explicitly, the level at which it pursues that objective. Thus, a panel adjudicating a claim under Article 2.2 must seek to ascertain—from the design, structure, and operation of the technical regulation, as well as from evidence relating to its application—to what degree, if at all,[93] the challenged technical regulation, as written and applied, actually contributes to the achievement of the legitimate objective pursued by the Member. (Emphasis added.)[94]

According to the Appellate Body, 'a panel must assess the contribution to the legitimate objective actually achieved by the measure at issue' much in the same way as is required when determining the contribution of a measure to the achievement of a particular objective in the context of Article XX GATT.[95] The 'question of whether a technical regulation "fulfils" an objective is concerned with the *degree* of contribution that the technical regulation makes toward the achievement of the legitimate objective' whereas 'the extent to which a measure contributes to the objective pursued' will be examined under 'necessity' criterion, discussed later.[96] Hence, the fulfilment requirement is met,

[90] Ibid. para. 315.
[91] *US—COOL* (Appellate Body), para. 373, referring to *US—Tuna II (Mexico)* (Appellate Body), para. 315.
[92] *US—Tuna II (Mexico)* (Appellate Body), para. 316.
[93] [Footnote 742 in the original] This may involve an assessment of whether the measure at issue is capable of achieving the legitimate objective (Appellate Body report, *US—Tuna II (Mexico)*, footnote 640 to para. 317).
[94] *US—COOL* (Appellate Body), para. 373.
[95] *US—Tuna II (Mexico)* (Appellate Body), para. 317, referring to *China—Publications and Audiovisual Products* (Appellate Body), para. 252; note the stricter language in *US—Tuna II (Mexico)* (Appellate Body), para. 317, fn. 640.
[96] *US—Tuna II (Mexico)* (Appellate Body), para. 341; confirmed in *US—COOL* (Appellate Body), para. 461.

when some objective capacity or suitability to contribute to the legitimate objective can be demonstrated. It suffices that the relevant technical regulation fulfils the member's 'objectives to a certain extent';[97] no minimum level of success or satisfaction is needed.[98] Note, however, that 'the degree of contribution made by the measure to the legitimate objective at issue' is again relevant in the following element of the TBT Article 2.2 analysis; there, however, it will be balanced and weighed with and against other criteria.[99] Observe further, that the 'contribution' requirement is not a sham: the Appellate Body demands, informed by its jurisprudence on GATT Article XX, 'a *genuine relationship of ends and means* between the objective pursued and the measure at issue.'[100] Thus, Panels are obliged to weigh-and-balance between the objective pursued and the measure at issue.

3.2.2.3 Determining whether the measure is 'necessary'

In *US—Tuna II*, the Appellate Body established a three-pronged *balancing test* for analysing whether a technical regulation is more trade-restrictive than necessary:

> A panel should begin by considering factors that include: (i) the degree of contribution made by the measure to the legitimate objective at issue; (ii) the trade-restrictiveness of the measure; and (iii) the nature of the risks at issue and the gravity of consequences that would arise from non-fulfilment of the objective(s) pursued by the Member through the measure.[101]

The Appellate Body then described the preceding test as a manner of excluding a more trade-restrictive measure:

> In most cases, a comparison of the challenged measure and possible alternative measures should be undertaken. In particular, it may be relevant for the purpose of this comparison to consider whether the proposed alternative is less trade restrictive, whether it would make an equivalent contribution to the relevant legitimate objective, taking account of the risks non-fulfilment would create, and whether it is reasonably available.[102]

In order to present a prima facie case to a Panel, the complaining state must establish—and, if need be, prove—the above criteria are met.

> [I]n most cases [a complainant] will, also seek to identify a possible alternative measure that is less trade restrictive, makes an equivalent contribution to the relevant objective, and is reasonably available. It is then for the respondent to rebut the complainant's prima facie case by presenting evidence and arguments showing that the challenged measure is not more trade restrictive than necessary to achieve the

[97] *US—Tuna II (Mexico)* (Appellate Body), para. 341; *US—COOL* (Appellate Body), paras. 466, 479.

[98] *US—COOL* (Appellate Body), para. 468.

[99] Note that GATT Art. XX requires, pursuant to *Brazil—Retreaded Tyres* (Appellate Body), para. 151, a 'material contribution' to the achievement of its objective.

[100] *US—COOL* (Appellate Body), para. 462, referring to *Brazil—Retreaded Tyres* (Appellate Body), para. 145.

[101] *US—Tuna II (Mexico)* (Appellate Body), para. 322; taken up in *US—COOL* (Appellate Body), paras. 374–8.

[102] *US—Tuna II (Mexico)* (Appellate Body), para. 322; taken up in *US—COOL* (Appellate Body), paras. 374–8.

> contribution it makes toward the objective pursued, for example, by demonstrating that the alternative measure identified by the complainant is not, in fact, "reasonably available", is not less trade restrictive, or does not make an equivalent contribution to the achievement of the relevant legitimate objective.[103] (Emphasis in the original.)

Thus, according to the Appellate Body, four elements have to be examined:

1. the measure's degree of contribution to the legitimate objective;
2. the trade-restrictiveness of the measure;
3. the risks of non-fulfilment of the legitimate objective; and
4. whether the challenged measure could have been substituted by a similarly affective reasonably available alternative measures.

We will address the criteria highlighted by the Appellate Body in turn.

1. Degree of contribution

The technical regulation's 'degree of contribution' is important in the light of the second criterion of 'trade restrictiveness'. A measure that decisively advances a legitimate policy objective, for instance reducing the human death-toll caused by diabetes or lung cancer, has a different relative weight in relation to the negative impact on trade than a measure that makes very insignificant contributions to a laudable policy goal. Therefore, Panels 'must seek to ascertain to what degree . . . the challenged technical regulation, as written and applied, actually contributes to the legitimate objective pursued'.[104] In this respect, 'the design, structure, and operation of the technical regulation', will be determinative.[105]

2. The trade-restrictiveness of the measure

In *US—Tuna II*, the Appellate Body, referring to its prior GATT jurisprudence, determined that 'trade-restrictiveness' meant 'having a limiting effect on trade'.[106] The subsequent reports did not give occasion to further explain that definition; it should be read broadly as covering all actual or potential, direct or indirect restrictions on trade.[107]

3. The nature of the risks at issue and the gravity of consequences that would arise from non-fulfilment of the objective(s) pursued by the member through the measure, taking into account alternative measures

Recall that the purpose of the TBT Article 2.2 analysis is to enable the Appellate Body and the Panels to

[103] *US—COOL* (Appellate Body), para. 379, referring to *US—Tuna II (Mexico)* (Appellate Body), para. 323.
[104] Ibid. para. 317.
[105] However, evidence regarding the application of the measure will also be relevant; ibid.
[106] Ibid. para. 319.
[107] In *US—COOL* (Panel), paras. 7.574–7.575, the Panel found the COOL measure to be 'trade-restrictive' within the meaning of TBT Art. 2.2, as it negatively affected imported products' conditions of competition in the US market in relation to like domestic products due to the higher costs on imported livestock; not discussed in *US—COOL* (Appellate Body), para. 477. See also *US—Tuna II* (Panel), para. 7.455.

> judge the "necessity" of the trade-restrictiveness of the measure at issue, that is, to discern whether the technical regulation at issue restricts international trade beyond what is necessary to achieve the degree of contribution that it makes to the achievement of a legitimate objective.[108]

It is in this light that the criterion of 'the nature of the risks at issue and the gravity of the consequences that would arise from non-fulfilment of the objective(s) pursued by the Member through the measure'[109] was developed by the Appellate Body. While in 'most cases, a comparison of the challenged measure and possible alternative measures will then also need to be undertaken',[110] such a comparative exercise is obsolete in 'at least two instances': 'when the measure is not trade restrictive at all, or when a trade-restrictive measure makes *no* contribution to the achievement of the relevant legitimate objective.'[111]

Any other state action is only an 'alternative' measure pursuant to the case law of the Appellate Body, if it pursues the same policy objective *and* advances it operationally in a similar way; in other words, it must show a degree of contribution to the fulfilment of the legitimate objective that is similar to that shown of the scrutinized measure. Last but not least, it must have been available under the circumstances prevailing at the time the measure was taken. The pertinent measure fails this necessity test, if 'a possible alternative measure, which is less trade restrictive, would make an equivalent contribution to the relevant legitimate objective, taking account of the risks non-fulfilment would create, and would be reasonably available.'[112]

The practical implementation of this test so far indicates that the Appellate Body rightly puts a premium on the right of members to define not only the acceptable level of risk, but also to define the intensity and the level of intervention of the chosen measures. Thus, in *US—Tuna II*, the Appellate Body rejected the Panel's view that a measure suggested by the complainant would have contributed 'to the same extent' as the chosen measure, because the United States could show that the alternative led to more damage to the species whose protection had been the very purpose of the US measure.[113]

3.3 Obligation to use international standards

Pursuant to TBT Article 2.4, the use of international standards[114] should be the standard operating procedure for domestic regulatory activities:

> Where technical regulations are required and relevant international standards exist or their completion is imminent, Members shall use them, or the relevant parts of them, as a basis for their technical regulations except when such international standards or relevant parts would be an ineffective or inappropriate means for the fulfilment of the

[108] *US—COOL* (Appellate Body), para. 461.
[109] *US—Tuna II (Mexico)* (Appellate Body), para. 322; *US—COOL* (Appellate Body), paras. 377–8.
[110] *US—Tuna II (Mexico)* (Appellate Body), para. 322.
[111] Ibid. fn. 647.
[112] *US—Tuna II (Mexico)* (Appellate Body), para. 321; see also *US—Gambling* (Appellate Body), para. 307.
[113] *US—Tuna II (Mexico)* (Appellate Body), para. 330.
[114] Humberto Schroder, 'Definition of the Concept "International Standard" in the TBT' (2009) *Journal of World Trade* 43, 1223–54.

legitimate objectives pursued, for instance because of fundamental climatic or geographical factors or fundamental technological problems.

TBT Article 2.5 then determines in detail what behaviour pursuant to TBT Article 2.4 entails:

> Whenever a technical regulation is prepared, adopted or applied for one of the legitimate objectives explicitly mentioned in paragraph 2, and is in accordance with relevant international standards, it shall be rebuttably presumed not to create an unnecessary obstacle to international trade.

In the following, we shall turn to the three constituent elements of the test mandated by TBT Article 2.4. The Panel needs to establish that (1) a 'relevant international standard' exists, (2) that the aforementioned standard was used as a basis of the technical regulation; and (3) that the international standard is an effective and appropriate means for the fulfilment of the legitimate objectives pursued.

3.3.1 Relevant international standard

A standard is international for the purposes of TBT Article 2.4 if it is approved by an international standardizing body.[115] Pursuant to Annex 1.4, an 'international body or system' has to be 'open to the relevant bodies of at least all Members.'[116] This has been confirmed by a decision of the TBT Committee, which repeated that an international body under TBT Article 2.4 should 'be open on a non-discriminatory basis to relevant bodies of at least all WTO Members'.[117]

The requirement that the international body is 'at least' open to all WTO members is is a difficult proposition, despite the Appellate Body's reference to both the treaty text and the decision of the TBT Committee:[118] A significant number of international bodies will not be open to all WTO members, in particular because some WTO members are not states or at least not universally recognized as such. Similar provisions in the SPS (Article 3.3 and 3.4) do not contain such a restriction. One may assume, therefore, that international standards pursuant to TBT Article 2.4 will become a rare phenomenon indeed, unless the TBT Committee would consensually change its position. However, this does not exclude a priori the relevance of international standards by international bodies not open to all the WTO membership. In *US—Clove Cigarettes*, WHO guidelines concerning the *Framework Convention on Tobacco Control*, were used not as international standards under TBT Article 2.5, but did serve as evidence for *factual findings*.[119] In *US—Tuna II*, the Appellate Body reversed the Panel's finding that the Agreement on International Dolphin Conservation Program (AIDCP) was an 'international standardizing organization' for the purposes of TBT Article 2.4 due to

[115] Note the distinction between 'body' and 'organization' in *US—Tuna II (Mexico)* (Appellate Body), para. 355 *et seq.*

[116] *US—Tuna II (Mexico)* (Appellate Body), para. 376.

[117] WTO Doc. G/TBT/1 Rev.11 (16 December 2013), Committee on Technical Barriers to Trade, Decisions and Recommendations adopted by the Committee since 1 January 1995, Note by the Secretariat.

[118] *US—Tuna II (Mexico)* (Appellate Body), para. 378.

[119] *US—Clove Cigarettes* (Panel), para. 7.230.

the fact that joining the organization was not a mere 'formality'. Therefore the organization lacked the openness 'to at least all WTO Members', which is required at 'every stage of standards development'.[120] Thus, the AIDCP did not constitute an 'international standardizing body' for the purposes of the TBT Agreement.

In order to be a *standardizing* body, the pertinent entity must have shown relevant standardization activities. While an international standardizing body need not have 'standardisation as its principal function'[121] and while prolific standard setting is not required,[122] members must reasonably be able to expect that the standardizing body is indeed involved in standard setting activities. Recognition of such status by fellow members and national standard setting bodies would also be relevant.[123]

The TBT adds the term 'relevant' to the term 'international standard'. In *EC—Sardines*, the EC had argued that the product coverage of the international standard and of the EC's technical regulation differed. Hence, the argument went, the former was not *relevant* for the latter: Whereas the international standard applied to twenty-one fish species, the EC technical regulation covered only one of them. This did not convince the Appellate Body. As the EC technical regulation did have legal implications for the marketing of all twenty-one species addressed by the international standard, the latter was held to be *relevant* for the EC measure addressing specifically one of the twenty-one species of fish.[124]

In the same report, the Appellate Body also confirmed the definition of *standard* in TBT Annex 1.2 as being not only relevant for domestic, that is, non-compulsory standards, but also for *international standards* that may be the basis for binding technical regulations;[125] it rejected the EC's argument that only standards adopted by consensus could qualify as *international standards*:

> The last sentence of the Explanatory note refers to "documents". The term "document" is also used in the singular in the first sentence of the definition of a "standard". We believe that "document(s)" must be interpreted as having the same meaning in both the definition and the Explanatory note. . . .
>
> Moreover, the text of the last sentence of the Explanatory note, referring to documents not based on consensus, gives no indication whatsoever that it is departing from the subject of the immediately preceding sentence, which deals with standards adopted by international bodies.[126]

3.3.2 Use of the relevant international standard as a basis

In *EC—Sardines*, the Appellate Body concluded that the requirement that an international standard[127] must be used 'as a basis for' a disputed technical regulation,

[120] *US—Tuna II (Mexico)* (Appellate Body), para. 374; the need for an invitation does not affect that openness, provided the invitation is a mere 'formality'. As the AIDCP would issue an invitation upon a consensus decision, that requirement was not met; ibid. para. 398 *et seq*.
[121] *US—Tuna II (Mexico)* (Appellate Body), para. 362.
[122] In fact, no more than one standard is necessary; *US—Tuna II (Mexico)* (Appellate Body), para. 360.
[123] Ibid. paras. 362, 363.
[124] *EC—Sardines* (Appellate Body), paras. 222 *et seq*., 232 *et seq*.
[125] Ibid. para. 222.
[126] Ibid. paras. 222, 223.
[127] If a 'part' is 'relevant', then it must be one of the elements which is 'a basis for' the technical regulation, ibid. paras. 248, 250; *US—Tuna II (Mexico)* (Panel), paras. 7.624–7.740.

required 'a very strong and very close relationship between' the international standard, on the one hand, and the technical regulation, on the other hand.[128] Thus, if

> the technical regulation and the international standard *contradict* each other, it cannot properly be concluded that the international standard has been used "as a basis for" the technical regulation [emphasis in the original].[129]

3.3.3 Is the relevant international standard an effective and appropriate means for the fulfilment of the legitimate objectives?

EC—Sardines offered the Appellate Body an opportunity to explore the terms *inappropriate* and *ineffective*: Peru had complained that the EC had deviated unjustifiably from an international standard determining the denomination of sardines.[130] According to the relevant EC Regulation,[131] only sardines conforming to four requirements could be marketed as such. One of these criteria was that they had to belong to the species *Sardina pilchardus Walbaum* ('*Sardina pilchardus*'), which could be found around the coasts of the Eastern North Atlantic Ocean, in the Mediterranean Sea, and in the Black Sea—but not in Peruvian fishing grounds. Therefore, this criterion could not possibly be fulfilled by the Peruvian product. Hence, pursuant to the EC legislation in dispute, Peru's exports were prohibited from using the word 'sardines' in the EC market, a prohibition that both parties to the dispute agreed to be incompatible with the international standard:

> [T]he term "ineffective or inappropriate means" refers to two questions—the question of the *effectiveness* of the measure and the question of the *appropriateness* of the measure—and . . . these two questions, although closely related, are different in nature. The Panel pointed out that the term "ineffective" "refers to something which is not 'having the function of accomplishing', 'having a result', or 'brought to bear', whereas [the term] 'inappropriate' refers to something which is not 'specially suitable', 'proper', or 'fitting'". The Panel also stated that:
>
> . . . [I]n the context of Article 2.4, an ineffective means is a means which does not have the function of accomplishing the legitimate objective pursued, whereas an inappropriate means is a means which is not specially suitable for the fulfilment of the legitimate objective pursued. . . . The question of effectiveness bears upon the *results* of the means employed, whereas the question of appropriateness relates more to the *nature* of the means employed. (Emphasis in the original.)[132]

Reversing the Panel's report in this respect, the Appellate Body decided further that if a WTO member does not use a relevant international standard as the basis for its technical regulation because it views it as ineffective or inappropriate, it is for the

[128] *EC—Sardines* (Appellate Body), para. 245. [129] Ibid. para. 248.

[130] The facts of the case described in paras. 2–8 of the Appellate Body report (WT/DS231/AB/R).

[131] Council Regulation (EEC) No 2136/89 of 21 June 1989 laying down common marketing standards for preserved sardines. OJ L 212, 22.7.1989, 79–81.

[132] *EC—Sardines* (Appellate Body), para. 285.

complaining party to demonstrate that the international standard in question is appropriate and effective for the respondent member to reach its objectives.[133] The Appellate Body, referring to its case law under the SPS, saw no reason to have a disparate treatment between the SPS and the TBT on the issue of the legal relevance of international standards. Note, however, that there is a major difference between the SPS and TBT regimes concerning international standards: in the SPS context, only standards issued by the standard setting institutions determined by the Agreement (or by subsequent consensus of the members) are capable of providing normatively relevant 'models'.

3.4 Equivalence and mutual recognition

Accepting as equivalent technical regulations of other states, even if the regulations differ from their domestic counterpart, is a relatively recent phenomenon. Rare exceptions apart, such as the unilateral introduction of the *Cassis de Dijon* principle by Switzerland vis-à-vis EU products,[134] such recognition of equivalence comes about on the basis of reciprocal mutual recognition agreements (MRAs) through which state parties accept defined standards of the partner as equivalent. Parties to such an agreement thus avoid, for the benefit of their economic operators, the burdensome obligation of requesting a conformity assessment by the importing state. TBT Article 2.7 encourages such activities, 'provided they are satisfied that these regulations adequately fulfil the objectives of their own regulations'.

Obviously, only states that have, at least with regard to certain product categories, similar ways of doing things, will be inclined to negotiate MRA agreements. Hence, many commentators are of the opinion that there is no such thing as a *non-discriminatory MRA*,[135] as the very conclusion is indicative of an atypical level of trust between the contracting parties. Arguably, the conclusion of an MRA is an advantage for the purposes of GATT Article I. However, TBT Article 6.4 lays down a rather modest special non-discrimination obligation in that context:

> Members are encouraged to permit participation of conformity assessment bodies located in the territories of other Members in their conformity assessment procedures under conditions no less favourable than those accorded to bodies located within their territory or the territory of any other country.

Members wanting to conclude an MRA would be well advised to leave the door open for other partners, provided that they meet the standards laid down in the MRA. So far, MRAs are confined to more or less 'homogeneous' contractual partners.

[133] Ibid. para. 282.

[134] Swiss manufacturers have the choice to align their products to the technical requirements of Switzerland or to those of the EU or an EU/EEA Member State, cf. Art. 16 *bis* of the Swiss Federal Law on Technical Barriers to Trade (THG) (<http://www.admin.ch/ch/d/sr/9/946.51.de.pdf>).

[135] Kalypso Nicolaidis, 'Non Discriminatory Mutual Recognition: An Oxymoron in the New WTO Lexicon?' in Thomas Cottier and Petros Mavroidis, eds., *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (University of Michigan Press, 2000) 267–301.

3.5 Performance requirements

Pursuant to TBT Article 2.8, members shall specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics. This important obligation reduces the risk of interventions aiming to favour domestic production by imposing adjustment costs to the international competition. An illustration may be helpful in this context: Enacting a law which requires fire-proof doors to be made out of a certain material (for instance metal), using certain methods (for instance folding it in a certain way) is supposed to be the *ancien régime*, outlawed by TBT Article 2.8. A WTO-compatible regulation will have to describe what fire-proof doors have to successfully do or prevent, for instance: a fire-proof door has to withstand for a defined time span (for instance, thirty minutes) defined conditions (such as, an open fire with temperatures above 200°C).

3.6 Additional obligations

TBT Article 2.5 and Article 2.9 impose on WTO members an *ex ante* transparency obligation: they have to notify, through the WTO Secretariat, all WTO members of their forthcoming technical regulations and, upon request, provide a justification for the intended regulatory intervention.[136] TBT Article 2.12 mandates further that a 'reasonable' period of time be allowed between the notification of the proposed technical regulation and its entry into force.

> Article 2.12 presumes that foreign producers in exporting Members, and particularly in developing country Members, require a minimum of at least six months to adapt to the requirements of an importing Member's technical regulation.[137]

However, the Doha Ministerial Declaration[138] allows an importing member to depart from the 6 month standstill obligation, if this interval 'would be ineffective to fulfil the legitimate objectives pursued' by the technical regulation.[139] In *US—Clove Cigarettes*, the Appellate Body and the Panel addressed in great detail how a claim under Art. 2.12 TBT had to be presented and rebutted.[140]

Note, that the notification requirements are less burdensome with respect to technical regulations adopted at the local government level, or by non-governmental bodies (TBT Article 3). If their content is substantially identical with that of previously notified schemes of central government bodies, a notification is obsolete.

[136] Note that the WTO provides at <http://tbtims.wto.org> the easily accessible 'Technical Barriers to Trade Information Management System (TBT IMS)'. This provides, inter alia, access to all members' notifications of technical regulations and conformity assessment procedures, notifications from standardizing bodies in relation to the Code of Good Practice, contact information for members' TBT Enquiry Points and Notification Authorities, and lastly information on specific trade concerns raised in the TBT Committee.

[137] *US—Clove Cigarettes* (Appellate Body), para. 274.

[138] Doha Ministerial Decision of 14 November 2001, WTO Doc. WT/MIN(01)/17 (20 November 2001), para. 5.2.

[139] *US—Clove Cigarettes* (Appellate Body), para. 275.

[140] Ibid. paras. 291–7.

WTO members are obliged to establish enquiry points, through which interested parties can request, pursuant to TBT Article 10, information about upcoming or already applicable technical regulations, hence ensuring *ex ante* and *ex post* transparency. In addition, TBT Article 2.11 imposes a publication requirement for all technical regulations adopted.[141]

3.7 Special and differential treatment

Pursuant to TBT Article 12.1

> Members shall provide differential and more favourable treatment to developing country Members to this Agreement, through the following provisions as well as through the relevant provisions of other Articles of this Agreement.

TBT Articles 12.2 and 12.3 require that WTO members shall give particular attention to the developing country members' special rights under TBT and their special development, financial, and trade needs, in particular when enacting technical regulations or standards. As with most provisions of this type, the obligation imposed is of a procedural nature, and not an obligation of result: 'giving active and meaningful consideration to such needs' suffices.[142] A more concrete obligation is contained in TBT Article 11, pursuant to which members shall, upon request, provide to fellow WTO members and in particular developing country members technical assistance on the development, administration, and application of technical regulations and standards.

3.8 Institutional provisions

Pursuant to TBT Article 13.1, a Committee on Technical Barriers to Trade (TBT Committee) is established. It is composed of representatives of all members, and meets when requested, but at least once a year. Like the SPS Committee, it is a much used forum for discussion and informal dispute resolution in which specific trade concerns are addressed and settled.[143] However, the Committee has also issued a significant number of decisions of great importance.[144] One such decision, laying down 'Principles for the Development of International Standards, Guides and Recommendations with Relation to Articles 2, 5 and Annex 3 of the [TBT] Agreement',[145] has been considered by the Appellate Body to be

> a "subsequent agreement" within the meaning of Article 31(3)(a) of the *Vienna Convention*. The extent to which this Decision will inform the interpretation and

[141] For exceptional circumstances, TBT Art. 2.10 exempts WTO members from their obligations under TBT Arts. 2.9 and 2.12; in such cases, they are only obliged to take comments into account.

[142] *US—COOL* (Panel), para. 7.790; see also *US—Clove Cigarettes* (Panel), paras. 7.596–7.649.

[143] Available at <http://tbtims.wto.org/web/pages/search/stc/Search.aspx>.

[144] cf. the compilation in WTO Doc. G/TBT/1 Rev.11, (16 December 2013), Committee on Technical Barriers to Trade, Decisions and Recommendations adopted by the Committee since 1 January 1995, Note by the Secretariat.

[145] Ibid. 46–8.

application of a term or provision of the *TBT Agreement* in a specific case, however, will depend on the degree to which it "bears specifically" on the interpretation and *application of the respective term or provision* (emphasis added).[146]

4. The SPS Agreement

4.1 Coverage

Originally envisaged as a part of the Agreement on Agriculture, the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement or SPS)[147] deals specifically with both the risks for humans and animals from food, and with the risks that arise for humans, as well as the flora and fauna surrounding them, from pests and diseases. Not surprisingly, many of the SPS cases are associated with island nations keen to protect their unique flora and fauna, which tend to have particularly stringent SPS regimes. However, some of the very same nations are often successful exporters of agricultural goods, and are therefore interested in creating a regime that regulates unreasonable and unnecessary import restrictions.

Thus, the SPS Agreement presents itself as a compromise: while SPS Article 2.1 emphasizes the right of members 'to take sanitary and phytosanitary measures necessary for the protection of human, animal or plant life or health', the following SPS Article 2.2 'ensure[s] that any sanitary or phytosanitary measure is applied only to the extent necessary to protect human, animal or plant life or health' *and* 'is based on scientific principles'.[148] Pursuant to its Article 1.1, the SPS Agreement applies

(1) to all sanitary and phytosanitary measures
(2) which may, directly or indirectly, affect international trade.

Like the TBT Agreement,[149] the SPS Agreement applies to all *currently applicable* state measures covered by the respective agreement.[150]

4.1.1 Sanitary or phytosanitary measure

Access to the regulating market is often conditional upon satisfying its SPS requirements: for instance, an importing member may request that certain foodstuffs (dairy

[146] *US—Tuna II (Mexico)* (Appellate Body), para. 372, referring, inter alia, to *US—Clove Cigarettes* (Appellate Body), para. 265 and *EC—Bananas III (Article 21.5—Ecuador II)/EC—Bananas III (Article 21.5—US)* (Appellate Body), para. 390.

[147] cf. Joanne Scott, *The WTO Agreement on Sanitary and Phytosanitary Measure A Commentary* (Oxford University Press, 2009); Lukasz Gruszczynski, *Regulating Health and Environmental Risk under WTO Law* (Oxford University Press, 2010); Marc Iynedjian, *L'Accord de l'Organisation Mondiale du Commerce sur L'application des Mesures Sanitaires et Phytosanitaires, Une Analyse Juridique* (L.G.D.J.: Paris, France, 2002).

[148] cf. *US/Canada—Continued Suspension* (Appellate Body), para. 587.

[149] *EC—Sardines* (Appellate Body), para. 216; *EC—Sardines* (Panel), para. 7.60.

[150] *EC—Hormones* (Appellate Body), para. 128; cf. VCLT Art. 28: SPS Art. 1 expresses the will of the parties to apply to all technical regulations, standards, and conformity assessment procedures in force, regardless of when those measures entered into force.

products or meats) are being subjected to procedures that eliminate any potential danger for their dairy or meat production. SPS Annex A provides an illustrative list of the type of measures that are regulated by the SPS Agreement:

> Sanitary or phytosanitary measures include all relevant laws, decrees, regulations, requirements and procedures including, *inter alia*, end product criteria; processes and production methods; testing, inspection, certification and approval procedures; quarantine treatments including relevant requirements associated with the transport of animals or plants, or with the materials necessary for their survival during transport; provisions on relevant statistical methods, sampling procedures and methods of risk assessment; and packaging and labelling requirements directly related to food safety.[151]

Pursuant to SPS Annex A(1), a *sanitary or phytosanitary measure* (SPS measure) is defined further by one of the following functions or interests:

(a) to protect animal or plant life or health within the territory of the member from risks arising from the entry, establishment or spread of pests, diseases, disease-carrying organisms, or disease-causing organisms;

(b) to protect human or animal life or health within the territory of the member from risks arising from additives, contaminants, toxins or disease-causing organisms in foods, beverages, or feedstuffs;

(c) to protect human life or health within the territory of the member from risks arising from diseases carried by animals, plants, or products thereof, or from the entry, establishment, or spread of pests; or

(d) to prevent or limit other damage within the territory of the member from the entry, establishment, or spread of pests.[152]

Note, that points (a), (c), and (d) focus on the dangers of varying magnitude emanating from the invasion of pests (accompanied, in the case of (a) by diseases, disease-carrying organisms, or disease-causing organisms); point (b) tackles dangers associated with food.

Despite the lack of a normative definition, the concept of 'measure' is a key concept for any complaint ('what is the measure complained against?'). Having regard to DSU Article 3.3, the Appellate Body has held that, in principle, any act or omission attributable to a WTO member is a measure; this would usually concern 'acts or omissions of the organs of the State',[153] including, of course, at the subnational level.[154] With regard to

[151] cf. *EC—Approval and Marketing of Biotech Products* (Panel), paras. 7.434–7.436, 7.1332–7.1337, and 7.2651–7.2922.

[152] cf. *EC—Approval and Marketing of Biotech Products* (Panel), paras. 7.434–7.436 and 7.2651–7.2922.

[153] *Australia—Apples* (Appellate Body), para. 171, referring to *US—Corrosion-Resistant Steel Sunset Review* (Appellate Body), para. 81.

[154] In many Federal states, such as the regular SPS users Australia or Canada, the measures are taken at the provincial or state level; cf. *Australia—Salmon (Article 21.5—Canada)* (Panel), para. 7.13. See also SPS Art. 13: 'Members are fully responsible under this Agreement for the observance of all obligations set forth herein. Members shall formulate and implement positive measures and mechanisms in support of the observance of the provisions of this Agreement *by other than central government bodies*. Members shall take such reasonable measures as may be available to them to ensure that non-governmental entities within their

private standards that are not relied upon, positively sanctioned, or controlled by the state, we would be reluctant, absent any state involvement (and absent an obligation to get involved) to find them attributable to the state under today's WTO law.[155]

In determining whether an act of a member is an SPS measure within the definition in SPS Annex A(1), regard must be had not just to its wording, legal form, and nature, but in particular to its purpose.[156] In *Australia—Apples*, the Appellate Body highlighted as a fundamental element of the definition of an SPS measure

> that such a measure must be one "applied to protect" at least one of the listed interests or "to prevent or limit" specified damage . . . The word "to" in adverbial relation with the infinitive verb "protect" indicates a purpose or intention. . . . In that sense, the Appellate Body in *Australia—Salmon* referred to a Member's "appropriate level of protection" and explained that this level is an *objective*, and that the SPS measure is an *instrument* chosen to attain or implement that objective . . .
>
> We consider that the meaning that has been attributed to the phrase "applied . . . so as to afford protection" in the context of Article III:1 of the GATT 1994 may provide some assistance to the interpretative task before us . . . Whether a measure is "applied . . . to protect" in the sense of Annex A(1)(a) must be ascertained not only from the objectives of the measure as expressed by the responding party, but also from the text and structure of the relevant measure, its surrounding regulatory context, and the way in which it is designed and applied. For any given measure to fall within the scope of Annex A(1)(a), scrutiny of such circumstances must reveal a clear and objective relationship between that measure and the specific purposes enumerated in Annex A(1)(a).[157]

In the *Biotech* case, the Panel gave an expansive interpretation of Annex A(1)(a) to (d);[158] in particular, it was not convinced by the EC's argumentation that the SPS Agreement was not intended to cover damages to the environment in general.[159] It is thus fair to say that Annex A (1) 'illustrate[s], through a set of . . . examples'[160] the broad scope of measures that will be covered by the disciplines of the SPS Agreement,

territories, as well as regional bodies in which relevant entities within their territories are members, comply with the relevant provisions of this Agreement. In addition, Members shall not take measures which have the effect of, directly or indirectly, requiring or encouraging such regional or non-governmental entities, or local governmental bodies, to act in a manner inconsistent with the provisions of this Agreement. Members shall ensure that they rely on the services of non-governmental entities for implementing sanitary or phytosanitary measures only if these entities comply with the provisions of this Agreement'. (Emphasis added.)

[155] cf. WTO Doc. G/SPS/GEN/1334, 18 June 2014, Committee on Sanitary and Phytosanitary Measures, Existing Definitions of Private Standards in other International Organizations, Note by the Secretariat.

[156] See *US—Poultry (China)* (Panel), para. 7.94, referring to *EC—Approval and Marketing of Biotech Products* (Panel), paras. 7.149 and 7.1334. As regards the *EC—Approval and Marketing of Biotech Products* case, see Robert Howse and Henrik Horn, 'European Communities—Measures Affecting the Approval and Marketing of Biotech Products' (2009) *World Trade Review* 8, 49–83.

[157] *Australia—Apples* (Appellate Body), paras. 172, 173, referring to *Australia—Salmon* (Appellate Body), para. 200; *EC—Approval and Marketing of Biotech Products* (Panel), para. 7.2558; *EC—Asbestos* (Appellate Body), para. 89; *Japan—Alcoholic Beverages II* (Appellate Body), 29.

[158] *EC—Approval and Marketing of Biotech Products* (Panel), paras. 7.212–7.416.

[159] Ibid. para. 7.197 *et seq.*; however, the Panel did find that the EU legislation on novel foods was outside the scope of the Annex A(1)(d).

[160] *Australia—Apples* (Appellate Body), para. 176.

provided the objective nexus to the specified purposes exist. In *US—Poultry*, the nexus was assumed for an appropriations bill that prohibited the use of funds for any administrative measure allowing the import of Chinese poultry. The measure had been taken in a situation in which major outbreaks of bird flu in China and sub-optimal reactions by the local authorities had been reported.[161]

4.1.2 Trade effect

Only SPS measures 'which may, directly or indirectly, affect international trade' are covered by the SPS Agreement. This is a low standard, as any potential ('may') and indirect effect suffices to get past that threshold. In particular, 'it is not necessary to demonstrate that an SPS measure has an actual effect on trade.'[162]

In parallel with the TBT, SPS measures can be enacted irrespective of whether or not there is domestic production. If there is domestic production, the regulating state must apply both the MFN principle and the NT obligations (SPS Article 2.3).

4.2 Basic rights and obligations

SPS Article 2 lays down the 'Basic Rights and Obligations' of members that inform the whole of the SPS Agreement.[163] Its paragraph 1 reads:

> Members have the right to take sanitary and phytosanitary measures necessary for the protection of human, animal or plant life or health, provided that such measures are not inconsistent with the provisions of this Agreement.

The fact that the *sedes materiae* for trade restrictions such as SPS measures is a provision establishing a *right to take SPS measures* (SPS Article 2.1) and not an exception (namely GATT Article XX) is not merely an (albeit important) semantic difference. Rather, it is a normative difference, and as such influences how disputes are handled under the SPS Agreement:

> [I]n any proceedings under the *SPS Agreement*[,] [t]he initial burden lies on the complaining party, which must establish a *prima facie* case of inconsistency with a particular provision of the *SPS Agreement* on the part of the defending party, or more precisely, of its SPS measure or measures complained about. When that *prima facie* case is made, the burden of proof moves to the defending party, which must in turn counter or refute the claimed inconsistency.[164]

However, the SPS Agreement is a compromise between the right of members to determine 'their' sanitary and phytosanitary measures and disciplines that concern both the procedure leading to SPS measures and their application. The rights of SPS Article 2.1 come with strings attached, namely the accompanying obligations indicated in SPS Articles 2.2 and 2.3. The first such 'string', SPS Article 2.2, reads:

[161] *US—Poultry (China)* (Panel), para. 7.119 *et seq.*
[162] Ibid. para. 7.435.
[163] *US—Poultry (China)* (Panel), para. 7.142.
[164] *EC—Hormones* (Appellate Body), para. 98.

> Members shall ensure that any sanitary or phytosanitary measure is applied only to the extent necessary to protect human, animal or plant life or health, is based on scientific principles and is not maintained without sufficient scientific evidence, except as provided for in paragraph 7 of Article 5.

SPS Article 2.2 refers to two requirements, which are further elaborated in SPS Articles 5 and 3. The first one encompasses the principle that an SPS measure shall be the least trade restrictive possible: in other words, only SPS measures that are *necessary* to attain the objective of 'protect[ing] human, animal or plant life or health' are permitted. This is developed further in SPS Article 5.6. The second requirement is that SPS measures need to be not only science-based 'at creation' but continuously supported by scientific evidence in order to be (and remain) WTO-compatible; this concept is further taken up in SPS Article 5.1.

SPS Article 2.2 is a reflection of the 'delicate and carefully negotiated balance ... between the shared, but sometimes competing, interests of promoting international trade and of protecting the life and health of human beings'[165] that permeates and informs the whole SPS Agreement. In its latest word to date on SPS Article 2.2, the Appellate Body held that this provision established 'the overarching requirement ... that there be a "rational or objective relationship" between the SPS measures and the scientific evidence'; SPS Articles 5.1 and 5.2 merely 'reflected' what the foundational provision of Article 2.2 required.[166] The close and almost inseparable relationship between the foundational provisions of SPS Article 2.2 and Article 5 is also reflected in the explicit reference to SPS Article 5.7:

> Article 2.2 excludes from its scope of application situations in which the relevant scientific evidence is insufficient. In such situations, the applicable provision is Article 5.7 of the *SPS Agreement*. ... [T]he relevant scientific evidence will be considered "insufficient" for purposes of Article 5.7 "if the body of available scientific evidence does not allow, in quantitative or qualitative terms, the performance of an adequate assessment of risks as required under Article 5.1 and as defined in Annex A to the *SPS Agreement*."[167]

The *second* 'string' attached to the basic right of SPS Article 2.1 is found in SPS Article 2.3:

> Members shall ensure that their sanitary and phytosanitary measures do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail, including between their own territory and that of other Members.

[165] *EC—Hormones* (Appellate Body), para. 177.

[166] *Australia—Apples* (Appellate Body), para. 215, referring to *US/Canada—Continued Suspension* (Appellate Body), para. 591 and *EC—Hormones* (Appellate Body), para. 193; see also *Japan—Agricultural Products II* (Appellate Body), para. 84; *Japan—Apples* (Appellate Body), para. 162 *et seq.*, and *EC—Hormones* (Appellate Body), para. 193. See also *US/Canada—Continued Suspension* (Appellate Body), para. 674: the 'requirement' established in SPS Art. 2.2 'is made operative in other provisions of the *SPS Agreement*, including Article 5.1, which requires SPS measures to be "based on" a risk assessment.'

[167] *US/Canada—Continued Suspension* (Appellate Body), para. 674, referring to *Japan—Apples* (Appellate Body), para. 179. See also *EC—Approval and Marketing of Biotech Products* (Panel), para. 7.2969 *et seq.* and *Japan—Agricultural Products II* (Appellate Body), para. 80.

> Sanitary and phytosanitary measures shall not be applied in a manner which would constitute a disguised restriction on international trade.

SPS Article 2.3 goes beyond the prohibition to not discriminate between 'like products';[168] rather it also allows the comparison with 'identical or similar conditions', which would seem to be a broader reference than the 'likeness' of, for instance, TBT Article 2.1 or GATT Article III:4. Again, the 'leitmotiv' of SPS Article 2.3 will be rendered operational by SPS Article 5, more specifically its paragraph 5.[169]

In *Australia—Salmon*, the Article 21.5 Panel developed a three-pronged test for a complaint based on SPS Article 2.3. The complaining state party needs to show that:

(1) the measure discriminates between the territories of members other than the member imposing the measure, or between the territory of the member imposing the measure and that of another member;
(2) the discrimination is arbitrary or unjustifiable; and
(3) identical or similar conditions prevail in the territory of the members compared.[170]

Whereas a violation of the more specific SPS Article 5.5 will always entail a violation of SPS Article 2.3, the reverse is not the case, due to the broader coverage of the latter.[171] Also,

> [d]iscrimination "between Members, including their own territory and that of others Members" within the meaning of Article 2.3, first sentence, can be established by following the complex and indirect route worked out and elaborated by Article 5.5. However, it is clear that this route is not the only route leading to a finding that an SPS measure constitutes arbitrary or unjustifiable discrimination according to Article 2.3, first sentence. Arbitrary or unjustifiable discrimination in the sense of Article 2.3, first sentence, can be found to exist without any examination under Article 5.5.[172]

The non-discrimination disciplines of SPS Article 2.3 are different from that enshrined in GATT Articles I and III: when enacting SPS measures, WTO members do not have to simply conform to non-discrimination; they are further obliged to base their interventions on scientific evidence, and are permitted to enact SPS measures where such evidence is insufficient only on a provisional basis as a precaution (SPS Article 5.7). Moreover, WTO members must ensure that their measures are not more trade restrictive than necessary to achieve their objective. Finally, they must also ensure consistency when enacting SPS measures, both with regard to the SPS Agreement and the self-selected level of risk.

[168] *Australia—Salmon (Article 21.5—Canada)* (Panel), para. 7.112.
[169] *Australia—Salmon* (Appellate Body), para. 178; *Australia—Salmon (Article 21.5—Canada)* (Panel), para. 7.112.
[170] *Australia—Salmon (Article 21.5—Canada)* (Panel), paras. 7.111–7.112.
[171] *Australia—Salmon* (Appellate Body), para. 252.
[172] Ibid.

4.3 International standards

4.3.1 Members shall base their sanitary or phytosanitary measures on international standards, guidelines, or recommendations

If and when a member chooses to take SPS measures, it is, in principle, obliged ('shall'), according to SPS Article 3.1,[173] to 'base' them 'on international standards, guidelines or recommendations', unless otherwise provided for in the SPS Agreement.[174] In *EC—Hormones*, the Appellate Body came to the conclusion that 'based on' had to mean '"stands" or is "founded" or "built" upon or "is supported by"'[175] the relevant international standards, guidelines, or recommendations and rejected the view that the obligation to 'base on' meant that the SPS measures had to 'conform to' Codex standards, guidelines, and recommendations.[176] Taking into account the wording of the Preamble to the SPS, which expresses the desire 'to further the use of harmonized [SPS] measures between Members on the basis of international standards, guidelines and recommendations developed by the relevant international organizations' as well as various other provisions of the SPS, the Appellate Body stated:

> [The] harmonization of SPS measures of Members on the basis of international standards is projected in the Agreement, as a *goal*, yet to be realized *in the future*. To read Article 3.1 as requiring Members to harmonize their SPS measures *by conforming those measures with international standards*, guidelines and recommendations, *in the here and now*, is, in effect, to vest such international standards, guidelines and recommendations (which are by the terms of the Codex *recommendatory* in form and nature) with *obligatory* force and effect. The Panel's interpretation ... [would] transform those standards, guidelines and recommendations into binding *norms*. But, as already noted, the *SPS Agreement* itself sets out no indication of any intent on the part of the Members to do so. We cannot lightly assume that sovereign states intended to impose upon themselves the more onerous, rather than the less burdensome, obligation by mandating *conformity* or *compliance with* such standards, guidelines and recommendations. To sustain such an assumption and to warrant such a far-reaching interpretation, treaty language far more specific and compelling than that found in Article 3 of the *SPS Agreement* would be necessary. (Emphasis in the original.)[177]

The declared purpose of the SPS Agreement is the reduction of variety and complexity of the many domestic SPS regimes through harmonization, that is, the establishment of one or several multilateral standards. However, due to the many exceptions in the remainder of SPS Article 3, the Appellate Body tends to leave the binding language of

[173] See the wording of SPS Art. 3: '1. To harmonize sanitary and phytosanitary measures on as wide a basis as possible, Members shall base their sanitary or phytosanitary measures on international standards, guidelines or recommendations, where they exist, except as otherwise provided for in this Agreement, and in particular in paragraph 3.'

[174] *EC—Hormones* (Appellate Body), paras. 102, 165–6, and 171.

[175] Ibid. paras. 163–4, referring to the usual dictionaries but also to *US—Underwear* (Appellate Body), para. 17.

[176] *EC—Hormones* (Appellate Body), paras. 162–4.

[177] Ibid. para. 165.

SPS Article 3.1 largely unmentioned, and speaks of 'encouragement of harmonization'.[178] International harmonization, or rather the use of an international standard not created by the user of a specific SPS measure, reduces substantially the risk for abuse of SPS measures, and also the suspicion of abuse, as a non-partisan foundation is used for the measure in question:

> The ultimate goal of the harmonization of SPS measures is to prevent the use of such measures for arbitrary or unjustifiable discrimination between Members or as a disguised restriction on international trade.[179]

In contrast to the TBT Agreement, the SPS Agreement identifies the institutions which will be accepted as standard setting authorities: According to SPS Article 3.4 and its Annex A(3), only three standard setting bodies are currently recognized by the SPS Agreement as being authoritative: (i) the Codex Alimentarius Commission (Codex) for food safety; (ii) the International Office of Epizootics (OIE) for animal health and zoonoses (now named the World Organization for Animal Health);[180] and, (iii) the International Plant Protection Convention Secretariat (IPPC) for plant health. The SPS Committee can identify other relevant international standard setting organizations, but has not exercised that competence to date.

The Agreement encourages members to participate, within the limits of their resources, in the work of relevant international organizations for the development and review of standards, guidelines, and recommendations, which have equal status under the SPS Agreement. *US—Continued Suspension* explained the purpose of this normative set-up:

> As the preamble of the *SPS Agreement* recognizes, one of the primary objectives of the *SPS Agreement* is to "further the use of harmonized sanitary and phytosanitary measures between Members, on the basis of international standards, guidelines and recommendations developed by the relevant international organizations". This objective finds reflection in [Art. 3 SPS], which encourages the harmonization of SPS measures on the basis of international standards, while at the same time recognizing the WTO Members' right to determine their *appropriate level of protection*. (Emphasis added.)[181]

Pursuant to SPS Article 3.2, sanitary or phytosanitary measures 'conforming to' international standards 'shall be deemed to be necessary to protect human, animal or plant life or health' *and* 'presumed to be consistent with' the SPS Agreement and the GATT 1994. It is fair to say, thus, that

> [i]nternational standards are given a prominent role under the *SPS Agreement*, particularly in furthering the objective of promoting the harmonization of sanitary

[178] *US/Canada—Continued Suspension* (Appellate Body), para. 692; see also *Australia—Apples* (Appellate Body), para. 215, referring inter alia to *Japan—Agricultural Products II* (Appellate Body), para. 84, *Japan—Apples* (Appellate Body), para. 162 *et seq.*, and *EC—Hormones* (Appellate Body), para. 193.

[179] *EC—Hormones* (Appellate Body), para. 177.

[180] <http://www.oie.int>.

[181] *US—Continued Suspension* (Appellate Body), para. 692, referring to *EC—Hormones* (Appellate Body), para. 165.

> and phytosanitary standards between WTO Members. This is to be achieved by *encouraging* WTO Members to base their SPS measures on international standards, guidelines or recommendations, where they exist. There is a rebuttable presumption that SPS measures that conform to international standards, guidelines or recommendations are "necessary to protect human, animal or plant life or health, and ... [are] consistent with the relevant provisions of this Agreement and of GATT 1994.[182]

As a matter of law, thus, the remainder of the SPS Agreement only affects those SPS measures that are not 'conforming to' an international standard and therefore not benefiting from the presumption of WTO-compatibility.

4.3.2 Deviating from international standards

According to SPS Article 3.3,[183] WTO members may deviate from an international standard in order to achieve a higher level of sanitary or phytosanitary protection than would be achieved by measures based on the relevant international standards, (a) if there is a scientific justification; *or* (b) as a consequence of the level of sanitary or phytosanitary protection a member determines to be appropriate (in accordance with its risk assessment pursuant to SPS Article 5).

Point (a) is further detailed in a footnote to SPS Article 3.3:

> For the purposes of paragraph 3 of Article 3, there is a scientific justification if, on the basis of an examination and evaluation of available scientific information in conformity with the relevant provisions of this Agreement, a Member determines that the relevant international standards, guidelines or recommendations are not sufficient to achieve its appropriate level of sanitary or phytosanitary protection.

Whereas SPS Article 3.3 explicitly mandates WTO members to respect SPS Article 5, whenever they have recourse to option (b), no similar obligation seems to be established by Article 3.3 for states choosing option (a). In *EC—Hormones*, the Appellate Body explained why a WTO member having recourse to option (a) still needs to perform a *risk assessment*:

> It is true that situation (a) does not speak of Articles 5.1 through 5.8. Nevertheless, two points need to be noted. First, the last sentence of Article 3.3 requires that "all measures which result in a [higher] level of ... protection", that is to say, measures falling within situation (a) as well as those falling within situation (b), be "not inconsistent with any other provision of [the SPS] Agreement". "Any other provision

[182] *US/Canada—Continued Suspension* (Appellate Body), para. 532.

[183] It reads: 'Members may introduce or maintain sanitary or phytosanitary measures which result in a higher level of sanitary or phytosanitary protection than would be achieved by measures based on the relevant international standards, guidelines or recommendations, if there is a scientific justification, or as a consequence of the level of sanitary or phytosanitary protection a Member determines to be appropriate in accordance with the relevant provisions of paragraphs 1 through 8 of Article 5. Notwithstanding the above, all measures which result in a level of sanitary or phytosanitary protection different from that which would be achieved by measures based on international standards, guidelines or recommendations shall not be inconsistent with any other provision of this Agreement.'

> of this Agreement" textually includes Article 5. Secondly, the footnote to Article 3.3, while attached to the end of the first sentence, defines "scientific justification" as an "examination and evaluation of available scientific information in conformity with relevant provisions of this Agreement ...". This examination and evaluation would appear to partake of the nature of the risk assessment required in Article 5.1 and defined in Annex A.4 of the *SPS Agreement*.[184]

In a later report, the Appellate Body developed this reasoning:

> A WTO Member that adopts an SPS measure resulting in a higher level of protection than would be achieved by measures based on international standards must nevertheless ensure that its SPS measure complies with the other requirements of the *SPS Agreement*, in particular Article 5. This includes the requirement to perform a risk assessment. At the same time, we recognize that, in order to perform a risk assessment, a WTO Member may need scientific information that was not examined in the process leading to the adoption of the international standard. We see no basis in Articles 3.3 and 5.1 of the *SPS Agreement* to conclude that WTO Members choosing a higher level of protection than would be achieved by a measure based on an international standard must frame the scope and methods of its risk assessment, including the scientific information to be examined, in the same manner as the international body that performed the risk assessment underlying the international standard.... In such a situation, the fact that the WTO Member has chosen to set a higher level of protection may require it to perform certain research as part of its risk assessment that is different from the parameters considered and the research carried out in the risk assessment underlying the international standard.
>
> ... [W]hatever level of protection a WTO Member chooses does not pre-determine the outcome of its determination of the sufficiency of the relevant scientific evidence. The determination as to whether available scientific evidence is sufficient to perform a risk assessment must remain, in essence, a rigorous and objective process.[185]

4.3.3 Burden of proof in cases of deviation from international standards

The *EC—Hormones* Panel was of the opinion that the European Community had the burden of proof that its deviation from the relevant international standard was justified under the SPS Agreement.[186] The Appellate Body disagreed and reversed this finding. In its view, WTO members wishing to avail themselves of the possibility of not using an international standard should not be penalized for their decision to do so:

> The presumption of consistency with relevant provisions of the *SPS Agreement* that arises under Article 3.2 in respect of measures that conform to international standards may well be an *incentive* for Members so to conform their SPS measures with such standards. It is clear, however, that a decision of a Member not to conform a particular

[184] *EC—Hormones* (Appellate Body), para. 175, also on this dispute see paras. 104, 172–3; *US/Canada—Continued Suspension (Appellate Body),* paras. 532, 534, and 694.

[185] *US/Canada—Continued Suspension (Appellate Body)*, paras. 685 and 686.

[186] cf. Dooa Abdel Motaal, 'The "Multilateral Scientific Consensus" and the World Trade Organization' (2004) *Journal of World Trade* 38, 855–76.

> measure with an international standard does not authorize imposition of a special or generalized burden of proof upon that Member, which may, more often than not, amount to a *penalty*. (Emphasis in the original.)[187]

According to the Appellate Body, it is for the complainant to demonstrate that the regulating state could have reached its objectives by adhering to the international standard in question; consequently, it did not see a need for deviation from the general rule that a complainant must present a prima facie case:

> [T]he relationship between Articles 3.1, 3.2 and 3.3 . . . is qualitatively different from the relationship between, for instance, Articles I or II and Article XX of the GATT 1994. . . . Article 3.3 recognizes the autonomous right of a Member to establish such higher level of protection, provided that that Member complies with certain requirements in promulgating SPS measures to achieve that level. The general rule in a dispute settlement proceeding requiring a complaining party to establish a *prima facie* case of inconsistency with a provision of the *SPS Agreement* before the burden of showing consistency with that provision is taken on by the defending party, is *not* avoided by simply describing that same provision as an "exception". In much the same way, merely characterizing a treaty provision as an "exception" does not by itself justify a "stricter" or "narrower" interpretation of that provision than would be warranted by examination of the ordinary meaning of the actual treaty words, viewed in context and in the light of the treaty's object and purpose, or, in other words, by applying the normal rules of treaty interpretation. . . .
>
> Under Article 3.3 of the *SPS Agreement*, a Member may decide to set for itself a level of protection different from that implicit in the international standard, and to implement or embody that level of protection in a measure not "based on" the international standard. . . . . The right of a Member to determine its own appropriate level of sanitary protection is an important right. This is made clear in the sixth preambular paragraph of the *SPS Agreement*: . . . [the] right of a Member to establish its own level of sanitary protection under Article 3.3 of the *SPS Agreement* is an autonomous right and *not* an "exception" from a "general obligation" under Article 3.1. (Emphasis in the original.)[188]

Thus, according to SPS Article 3, members should either base their SPS measures on international standards—the recommended route—or may proceed unilaterally with a higher level of protection, provided the latter can be scientifically justified.

4.4 Assessment of risk

4.4.1 Introduction

Pursuant to SPS Article 5.1, members shall ensure that their SPS measures 'are based on an assessment, as appropriate to the circumstances, of the risks to human, animal or plant life or health, taking into account risk assessment techniques developed by the

[187] *EC—Hormones* (Appellate Body), para. 102. See also *US/Canada—Continued Suspension* (Appellate Body), paras. 576–84; 713–18.

[188] *EC—Hormones* (Appellate Body), paras. 104 and 172; see, more recently, *US/Canada—Continued Suspension* (Appellate Body), para. 532.

relevant international organizations'. SPS Articles 5.2 and 5.3 determine additional disciplines for risk assessment:[189]

> 2. In the assessment of risks, Members shall take into account available scientific evidence; relevant processes and production methods; relevant inspection, sampling and testing methods; prevalence of specific diseases or pests; existence of pest- or disease-free areas; relevant ecological and environmental conditions; and quarantine or other treatment.
>
> 3. In assessing the risk to animal or plant life or health and determining the measure to be applied for achieving the appropriate level of sanitary or phytosanitary protection from such risk, Members shall take into account as relevant economic factors: the potential damage in terms of loss of production or sales in the event of the entry, establishment or spread of a pest or disease; the costs of control or eradication in the territory of the importing Member; and the relative cost-effectiveness of alternative approaches to limiting risks.

In contrast, SPS Article 5.4 addresses the level of risk a member is prepared to accept:

> 4. Members should, when *determining the appropriate level of sanitary or phytosanitary protection*, take into account the objective of minimizing negative trade effects. (Emphasis added.)

The process to denote the level of risk that a member and its society are prepared to accept—the subjectively defined 'appropriate level of sanitary or phytosanitary protection' (ALOP, SPS Article 5.4) and the measures they are prepared to use against the risk (SPS Article 5.5, 5.6) are often covered by the term 'risk management'. It does not help that this term does not appear in the SPS Agreement, whereas the term 'risk assessment' is exhaustively addressed in SPS Articles 5.1 to 5.3 and describes the scientific evaluation of the status quo and of future developments according to scientific methods and insights.[190]

The determination of the ALOP pursuant to SPS Article 5.4 should—in a rational political process—follow *some* form of risk assessment. 'Members' appropriate level of protection' (SPS Article 5.4) can legitimately differ significantly across jurisdictions, as the SPS Agreement fully embraces the right of members to show varying appetites for risk. Depending on the degree of probability, any given society, depending on its aversion to a specific risk, will define the level of protection it deems appropriate. However,

> [t]he "appropriate level of protection" established by a Member and the "SPS measure" have to be clearly distinguished. They are not one and the same thing. The first is an *objective*, the second is an *instrument* chosen to attain or implement that objective. It can be deduced from the provisions of the *SPS Agreement* that the determination by a Member of the "appropriate level of protection" logically precedes the establishment or decision on maintenance of an "SPS measure". The provisions of the *SPS Agreement* also clarify the correlation between the "appropriate level of protection" and the "SPS measure". . . .

[189] The term risk assessment is defined in SPS Annex A(4).

[190] SPS Annex A(4).

> ... The words of Article 5.6, in particular the terms "*when establishing or maintaining* sanitary ... protection", demonstrate that the determination of the level of protection is an element in the decision-making process which logically *precedes* and is *separate* from the establishment or maintenance of the SPS measure. It is the appropriate level of protection which determines the SPS measure to be introduced or maintained, not the SPS measure introduced or maintained which determines the appropriate level of protection. To imply the appropriate level of protection from the existing SPS measure would be to assume that the measure always achieves the appropriate level of protection determined by the Member. That clearly cannot be the case. (Emphasis in the original.)[191]

The distinction between risk assessment and risk management had been used by the panel in *EC—Hormones*. Finding no textual basis in the Agreement for this categorization, the Appellate Body dismissed its relevance in a schoolmasterly tone.[192] However, one should not read too much into this rejection. A few paragraphs later, the Appellate Body declared that there is no such thing as a minimum magnitude of risk below which no regulatory intervention is possible.[193] SPS Article 5.1 is accompanied by SPS Article 5.2. In the following, we shall address some of the more salient questions relating to these provisions.[194]

4.4.2 Risk assessment proper

4.4.2.1 The obligation to have recourse to scientific evidence

It will be recalled that pursuant to SPS Article 2.2, members shall ensure that any SPS measure 'is based on scientific principles and is not maintained without sufficient scientific evidence', unless an exception allows otherwise.[195] Importantly, SPS Article 2.2 'informs' SPS Article 5.1,[196] which reads:

> Members shall ensure that their sanitary or phytosanitary measures are based on an assessment, as appropriate to the circumstances, of the risks to human, animal or plant life or health, taking into account risk assessment techniques developed by the relevant international organizations.

The rationale for both SPS Articles 2.2 and 5.1 was discussed in *EC—Hormones*, where the Appellate Body stated that the two provisions strike a balance between the promotion of world trade and the protection of life and health of humans:

> The requirements of a risk assessment under Article 5.1, as well as of "sufficient scientific evidence" under Article 2.2, are essential for the *maintenance of the delicate*

[191] *Australia—Salmon* (Appellate Body), paras. 200, 201, and 203.

[192] *EC—Hormones* (Appellate Body), para. 181 *et seq.* [193] Ibid. para. 186.

[194] The order of analysing the claims under SPS provisions was discussed in *US—Poultry (China)* (Panel), paras. 7.157–7.161.

[195] This paragraph reflects the precautionary principle, which is discussed later in the chapter.

[196] '[S]imilarly[,] Article 2.3 informs Article 5.5', *EC—Hormones* (Appellate Body), para. 250; following this line of logic, the Appellate Body clarified in *Australia—Salmon* (Appellate Body), para. 138, that a violation of SPS Art. 2.2 amounted *ipso facto* to a violation of SPS Art. 5.1; see also *Australia—Apples* (Appellate Body), paras. 185–248.

and carefully negotiated balance in the SPS Agreement between the shared, but sometimes competing, interests of promoting international trade and of protecting the life and health of human beings....

...Article 5.1 may be viewed as a specific application of the basic obligations contained in Article 2.2 of the *SPS Agreement*... Articles 2.2 and 5.1 should constantly be read together. Article 2.2 informs Article 5.1: the elements that define the basic obligation set out in Article 2.2 impart meaning to Article 5.1. (Emphasis added.)[197]

4.4.2.2 Defining risk

In *EC—Hormones*, the Appellate Body made two important clarifications concerning the definition of risk. It held, first, that the risk must be identifiable:

[T]he Panel opposes a requirement of an "identifiable risk" to the uncertainty that theoretically always remains since science can *never* provide *absolute* certainty that a given substance will not *ever* have adverse health effects. We agree with the Panel that this theoretical uncertainty is not the kind of risk which, under Article 5.1, is to be assessed.[198]

Second, it made clear that the risk envisaged in the body of the SPS is not just 'laboratory risk' but a 'real world risk' that takes into account behavioural factors, and coined a now famous definition of what the term 'real world' is supposed to mean:

[T]he risk that is to be evaluated in a risk assessment under Article 5.1 is not only risk ascertainable in a science laboratory operating under strictly controlled conditions, but also risk in human societies as they actually exist, in other words, the actual potential for adverse effects on human health in the real world where people live and work and die.[199]

Thus, the risk to be assessed according to SPS Article 5.1 must be an 'ascertainable' risk.[200]

4.4.2.3 Two types of risk assessment

SPS measures are to be 'based on' a 'risk assessment'. The latter term is defined in SPS Annex A(4):

Risk assessment—The evaluation of the likelihood of entry, establishment or spread of a pest or disease within the territory of an importing Member according to the sanitary or phytosanitary measures which might be applied, and of the associated potential biological and economic consequences; *or* the evaluation of the potential for

[197] *EC—Hormones* (Appellate Body), paras. 177 and 180; see also paras. 181, 183–4, and 190; *Australia—Salmon* (Appellate Body), para. 138; *Japan—Agricultural Products II* (Appellate Body), paras. 73–4, 80, and 84; *Japan—Apples* (Appellate Body), paras. 163–4; *US/Canada—Continued Suspension* (Appellate Body), paras. 527, 530, 534, 541–2, 591, and 674; *Australia—Apples* (Appellate Body), paras. 261–2.

[198] *EC—Hormones* (Appellate Body), para. 186; see *US/Canada—Continued Suspension* (Appellate Body), para. 569.

[199] *EC—Hormones* (Appellate Body), para. 187; see also *Australia—Salmon* (Appellate Body), para. 125; *Japan—Apples* (Appellate Body), para. 241.

[200] In *Japan—Apples*, the Appellate Body cautioned, however, that 'scientific prudence' should 'not be "completely assimilated"' to such theoretical uncertainty (*Japan—Apples* (Appellate Body), para. 241).

adverse effects on human or animal health arising from the presence of additives, contaminants, toxins or disease-causing organisms in food, beverages or feedstuffs. (Emphasis added.).

The SPS Agreement thus establishes two different types of risk assessment[201] depending on which risk they are supposed to address. The first type is *risk assessment with regard to pests and diseases* (Annex A(4), First Alternative). The assessment evaluates the *likelihood* of entry, establishment and spread, on the one hand, and the biological and economic consequences of the invasion, on the other hand.
In its report in *Australia—Salmon*, the Appellate Body defined risk assessment pursuant to SPS Article 5.1, SPS Annex A(4) First Alternative. Its purpose was to:

(1) *identify* the diseases whose entry, establishment or spread a Member wants to prevent within its territory, as well as the potential biological and economic consequences associated with the entry, establishment or spread of these diseases;
(2) *evaluate the likelihood* of entry, establishment or spread of these diseases, as well as the associated potential biological and economic consequences; and
(3) evaluate the likelihood of entry, establishment or spread of these diseases *according to the SPS measures which might be applied.*[202]

The second type of risk assessment concerns 'the potential for adverse effects on human or animal health' (Annex A(4), Second Alternative). The evaluation focuses on whether such potential arises from the presence of additives, contaminants, toxins, or disease-causing organisms in food, beverages, or feedstuffs. Quite clearly, in view of the high value of the protected interest (harm to humans and animals), there is no need to analyse separately the 'biological and economic consequences'. Note, that the same value judgement is evident in SPS Article 5.3.[203]

With regard to the second type of risk assessment which serves to evaluate dangerous impact on humans and animals, a less demanding test was established by the *EC—Hormones* Panel, and endorsed, albeit less than enthusiastically, by the Appellate Body:

> Interpreting [Annex A(4), Second Alternative], the Panel elaborates risk assessment as a two-step process that "should (i) *identify* the *adverse effects* on human health (if any) arising from the presence of the hormones at issue when used as growth promoters *in meat*..., and (ii) if any such adverse effects exist, *evaluate* the *potential* or probability of occurrence of such effects".

[201] *Australia—Salmon* (Appellate Body), paras. 123, fn. 69 and 124; *US/Canada—Continued Suspension* (Appellate Body), paras. 569, 572, 574, and fn. 1176.
[202] *Australia—Salmon* (Appellate Body), para. 121.
[203] SPS Art. 5.3 reads: 'In assessing the risk to animal or plant life or health and determining the measure to be applied for achieving the appropriate level of sanitary or phytosanitary protection from such risk, Members shall take into account as relevant economic factors: the potential damage in terms of loss of production or sales in the event of the entry, establishment or spread of a pest or disease; the costs of control or eradication in the territory of the importing Member; and the relative cost-effectiveness of alternative approaches to limiting risks.'

> ... The ordinary meaning of "potential" relates to "possibility" and is different from the ordinary meaning of "probability". "Probability" implies a higher degree or a threshold of potentiality or possibility. (Emphasis in the original.)[204]

Hence, the Appellate Body-approved test for the Annex A(4), Second Alternative, risk assessment would be to (1) *identify* the *adverse effects* on human health (if any) arising from the presence of additives, contaminants, toxins, or disease-causing organisms in food, beverages, or feedstuffs; and (2) if any adverse effects exist, *evaluate* the *potential* or probability of occurrence of such effects.

4.4.3 Methodology to be used

4.4.3.1 In general

SPS Article 5.2 imposes the legal obligation ('shall') to take into account

- available scientific evidence;
- relevant processes and production methods;
- relevant inspection, sampling, and testing methods;
- prevalence of specific diseases or pests;
- existence of pest- or disease-free areas;
- relevant ecological and environmental conditions; and
- quarantine or other treatment

when performing a risk assessment. Whereas the Appellate Body has been mute with regard to which additional 'other' factors could (and should) be used, it has emphasized that the list in SPS Article 5.2 is (1) not a closed list, and, in particular, (2) that abuse or misuse and difficulties of control in the administration of the pest or disease may be considered in the context of a risk assessment,[205] or, in other words 'factors that are not susceptible of quantitative analysis by the empirical or experimental laboratory methods commonly associated with the physical sciences.'[206]

In particular with regard to Annex A(4), Second Alternative, the state undertaking a risk assessment pursuant to SPS Article 5.1 in order to support an SPS measure has to establish a risk according to the methodology of its choosing, provided it stays within the parameters established by SPS Articles 5.1 and 5.2:

> Although the definition of a risk assessment does not require WTO Members to establish a minimum magnitude of risk, it is nevertheless difficult to understand the concept of risk as being devoid of any indication of potentiality. A risk assessment is intended to identify adverse effects and evaluate the possibility that such adverse effects might arise. This distinguishes an ascertainable risk from theoretical uncertainty. However, the assessment of risk need not be expressed in numerical terms or as a minimum quantification of the level of risk. We are also mindful that the risk

[204] *EC—Hormones* (Appellate Body), paras. 183, 184, referring to *EC—Hormones (US)* (Panel), para. 8.98; *EC—Hormones (Canada)* (Panel), para. 8.101.

[205] *US/Canada—Continued Suspension* (Appellate Body), para. 535, referring to *EC—Hormones* (Appellate Body), paras. 187, 206; see also *Australia—Apples* (Appellate Body), paras. 206–7.

[206] *Australia—Apples* (Appellate Body), para. 207.

> assessment at issue in this case concerns the *potential* for adverse effects under the second sentence of paragraph 4 of Annex A and not an evaluation of likelihood under the first sentence of paragraph 4. (Emphasis in the original.)[207]

In the context of the *Japan—Apples* dispute, the question arose as to whether the SPS measure in question prejudges the methodology to be used in the context of risk assessment. The Appellate Body opined that the SPS Agreement did not impose a particular methodology.[208] However, it did require close connection ('specificity') between the methodology used and the factual situation that gave rise to the risk assessment in the first place:

> [E]ven though, in a given context, a risk assessment must consider a specific agent or pathway through which contamination might occur, Members are not precluded from organizing their risk assessments along the lines of the disease or pest at issue, or of the commodity to be imported. Thus, Members are free to consider in their risk analysis multiple agents in relation to one disease, provided that the risk assessment attributes a likelihood of entry, establishment or spread of the disease to each agent specifically.[209]

In any case, an SPS measure requires a risk assessment pursuant to SPS Article 5.1 and 5.2 that shows a 'rational or objective relationship between the SPS measure and the scientific evidence' in order to be WTO-compatible.[210] In that context, the Appellate Body recognizes that science is not a secular god, and scientific findings are subject to change. Therefore, a risk assessment has neither 'to come to a monolithic conclusion that coincides with the scientific conclusion', nor does it need to slavishly follow the *majority* opinion in the relevant scientific community:

> The risk assessment could set out both the prevailing view representing the "main-stream" of scientific opinion, as well as the opinions of scientists taking a divergent view. Article 5.1 does not require that the risk assessment must necessarily embody only the view of a majority of the relevant scientific community. . . . In most cases,

[207] *US/Canada—Continued Suspension* (Appellate Body), para. 569, referring to *EC—Hormones* (Appellate Body), para. 184, where it had stated that the term 'potential for adverse effects' referred to the possibility of occurrence of adverse effects, and not to 'probability', which implies a higher degree of potentiality. See also *US/Canada—Continued Suspension* (Appellate Body), paras. 570 *et seq*., 574.

[208] However, depending on the reading of SPS Art. 5.1, one could also hold the view that the SPS does impose a certain methodology that was used by the relevant international organizations. The Appellate Body in this report seems to suggest that risk assessment techniques and methodology used are two distinct issues. There is not much support for this view, however, in scientific discourse. See Gavin Goh, 'Tipping the Apple Cart: The Limits of Science and Law in the SPS Agreement after *Japan—Apples*' (2006) *Journal of World Trade* 40, 655–86.

[209] *Japan—Apples* (Appellate Body), para. 204; see also *EC—Hormones* (Appellate Body), paras. 199 and 206; *Japan—Apples* (Appellate Body), paras. 202 and fn. 372, 203 and fn. 379; *US/Canada—Continued Suspension (Appellate Body)*, paras. 530, 547, 552, 553, 559, 562, and 563.

[210] *Japan—Agricultural Products II* (Appellate Body), para. 84, confirmed by *Australia—Apples* (Appellate Body), para. 208. 'Whether there is a rational relationship between an SPS measure and the scientific evidence is to be determined on a case-by-case basis and will depend upon the particular circumstances of the case, including the characteristics of the measure at issue and the quality and quantity of the scientific evidence.'

> responsible and representative governments tend to base their legislative and administrative measures on "mainstream" scientific opinion. In other cases, equally responsible and representative governments may act in good faith on the basis of what, at a given time, may be a divergent opinion coming from qualified and respected sources. By itself, this does not necessarily signal the absence of a reasonable relationship between the SPS measure and the risk assessment, especially where the risk involved is life-threatening in character and is perceived to constitute a clear and imminent threat to public health and safety. Determination of the presence or absence of that relationship can only be done on a case-to-case basis, after account is taken of all considerations rationally bearing upon the issue of potential adverse health effects.[211]

While this may sound rather unspecific, the Appellate Body's subsequent practice in applying these standards makes clear that it is prepared to examine in detail what a member claims to be a risk assessment. To quote from *Japan—Apples*:

> [T]he obligation to conduct an assessment of "risk" is not satisfied merely by a general discussion of the disease sought to be avoided by the imposition of a phytosanitary measure. [Footnote 372: [A]s a general matter, "risk" cannot usually be understood only in terms of the disease or adverse effects that may result. Rather, an evaluation of risk must connect the possibility of adverse effects with an antecedent or cause. For example, the abstract reference to the "risk of cancer" has no significance, in and of itself, under the *SPS Agreement*; but when one refers to the "risk of cancer from smoking cigarettes", the particular risk is given content.]
>
> The Appellate Body found the risk assessment at issue in *EC—Hormones* not to be "sufficiently specific" even though the scientific articles cited by the importing Member had evaluated the "carcinogenic potential of entire *categories* of hormones, or of the hormones at issue *in general*."[212] In order to constitute a "risk assessment" as defined in the *SPS Agreement*, the Appellate Body concluded, the risk assessment should have reviewed the carcinogenic potential, not of the relevant hormones in general, but of "residues of those hormones found in meat derived from cattle to which the hormones had been administered for growth promotion purposes". Therefore, when discussing the risk to be specified in the risk assessment in *EC—Hormones*, the Appellate Body referred in general to the harm concerned (cancer or genetic damage) *as well as* to the precise agent that may possibly cause the harm (that is, the specific hormones when used in a specific manner and for specific purposes). (Emphasis in the original.)[213]

[211] *EC—Hormones* (Appellate Body), para. 194.

[212] [Footnote 373 in the original] Appellate Body Report, para. 199. In other words, the risk assessment proffered by the importing Member in *EC—Hormones* considered the relationship between the broad *grouping* of hormones that were the subject of the measure and cancer.

[213] *Japan—Apples* (Appellate Body), para. 202; cf. Henrik Horn and Petros Mavroidis, 'National Health Regulations and the SPS Agreement: The WTO Case-law of the Early Years' in Thomas Cottier and Petros Mavroidis, eds., *The Role of the Judge in International Trade Regulation* (University of Michigan Press, 2003) 255–86; Tracey Epps, *International Trade and Health Protection: A Critical Assessment of the WTO's SPS Agreement* (Edward Elgar Publishing, 2008); Jacqueline Peel, *Science and Risk Regulation in International Law* (Cambridge University Press, 2010).

The state of play seems well reflected in the following lengthy quotation from *Australia—Apples*:

> 207. Science plays a central role in risk assessment and, therefore, a risk assessment is "a process characterized by systematic, disciplined and objective enquiry and analysis, that is, a mode of studying and sorting out facts and opinions".[214] . . .
>
> 208. Thus, Article 5.2 requires a risk assessor to take into account the available scientific evidence, together with other factors. Whether a risk assessor has taken into account the available scientific evidence in accordance with Article 5.2 of the *SPS Agreement* and whether its risk assessment is a proper risk assessment within the meaning of Article 5.1 and Annex A(4) must be determined by assessing the relationship between the conclusions of the risk assessor and the relevant available scientific evidence. . . .
>
> 210. We observe that, in its decisions under Articles 2.2 and 5.1 of the *SPS Agreement*, the Appellate Body has identified the role of a panel assessing compliance with these provisions as an inquiry into whether there is a "rational or objective relationship" between the SPS measures and the scientific evidence and between the SPS measures and the risk assessment.[215]
>
> 211. The standard of review in proceedings under the *SPS Agreement* "must reflect the balance established in that Agreement between the jurisdictional competences conceded by the Members to the WTO and the jurisdictional competences retained by the Members for themselves".[216] The applicable standard of review is set out in Article 11 of the DSU . . .
>
> 212. In *EC—Hormones*, the Appellate Body clarified that this standard of review requires that a panel reviewing a risk assessment under Article 5.1 of the *SPS Agreement* neither undertake a *de novo* review, nor give "total deference" to the risk assessment it reviews.[217]
>
> 213. In *US/Canada—Continued Suspension*, the Appellate Body further clarified the standard of review that applies to a panel reviewing the conformity of a measure with Article 5.1 of the *SPS Agreement*. The Appellate Body stated that, under this provision, a panel's task is to review a WTO Member's risk assessment and not to substitute its own scientific judgement for that of the risk assessor. A panel should not, therefore, determine whether the risk assessment is correct, but rather "determine whether that risk assessment is supported by coherent reasoning and respectable scientific evidence and is, in this sense, objectively justifiable".[218]

[214] [Footnote 339 in the original] *US/Canada—Continued Suspension* (Appellate Body), para. 527 (quoting *EC—Hormones* (Appellate Body)), para. 187.

[215] [Footnote 342 in the original] In *Japan—Agricultural Products II* the Appellate Body stated that 'the obligation in Article 2.2 that an SPS measure not be maintained without sufficient scientific evidence requires that there be a rational or objective relationship between the SPS measure and the scientific evidence' (Appellate Body Report, *Japan—Agricultural Products II,* para. 84). See also Appellate Body Report, *Japan—Apples*, paras. 162 and 163.

[216] [Footnote 343 in the original] Appellate Body Report, *EC—Hormones*, para. 115.

[217] [Footnote 344 in the original] ibid. para. 117.

[218] [Footnote 345 in the original] Appellate Body Reports, *US/Canada—Continued Suspension*, para. 590.

214. More specifically, at paragraph 591 of its reports in *US/Canada—Continued Suspension*, the Appellate Body stated that, with respect to the scientific basis underlying an SPS measure, a panel should verify whether it "comes from a respected and qualified source" and has "the necessary scientific and methodological rigour to be considered reputable science". The Appellate Body explained that, "while the correctness of the views need not have been accepted by the broader scientific community, the views must be considered to be legitimate science according to the standards of the relevant scientific community." With respect to the reasoning of the risk assessor, the Appellate Body observed in the same paragraph of the *US/Canada—Continued Suspension* reports that:

[a] panel should also assess whether the reasoning articulated on the basis of the scientific evidence is objective and coherent. In other words, a panel should review whether the particular conclusions drawn by the Member assessing the risk find sufficient support in the scientific evidence relied upon.

215. Thus, in its discussion of the standard of review that applies to a panel reviewing a risk assessment under Article 5.1 of the *SPS Agreement*, the Appellate Body identified two aspects of a panel's scrutiny of a risk assessment, namely, scrutiny of the underlying scientific basis and scrutiny of the reasoning of the risk assessor based upon such underlying science. With respect to the first aspect, the Appellate Body saw the panel's role as limited to reviewing whether the scientific basis constitutes "legitimate science according to the standards of the relevant scientific community". The Appellate Body perceived the second aspect of a panel's review as involving an assessment of whether the reasoning of the risk assessor is objective and coherent, that is, whether the conclusions find sufficient support in the scientific evidence relied upon. Having done so, the panel must determine whether the results of the risk assessment sufficiently warrant the challenged SPS measures.[219] We consider that this reasoning of the Appellate Body is consistent with the overarching requirement in Article 2.2 and reflected in Articles 5.1 and 5.2 of the *SPS Agreement* that there be a "rational or objective relationship" between the SPS measures and the scientific evidence.[220]

Members may substitute a self-administered assessment by a risk assessment undertaken by either another WTO member or by an international organization.[221] However,

while Article 5.1 directs a Member conducting a pest risk assessment to take into account internationally developed risk assessment techniques, this does not mean that a risk assessment must be based on or conform to such techniques. Nor does it imply that compliance with such techniques alone suffices to demonstrate compliance with a Member's obligations under the *SPS Agreement*. However, reference by the risk assessor to such techniques is useful both to the risk assessor, should a dispute arise in relation to the risk assessment, and to the panel that is called upon to review the consistency of that risk assessment with the provisions of the *SPS Agreement*.[222]

[219] [Footnote 346 in the original] Appellate Body reports, *US/Canada—Continued Suspension*, para. 591 (referring to Appellate Body report, *EC—Hormones*, para. 193).

[220] *Australia—Apples* (Appellate Body), paras. 207–15.

[221] *EC—Hormones* (Appellate Body), para. 190.

[222] *Australia—Apples* (Appellate Body), para. 246, containing the footnote 377: 'We observe that the panel in *Japan—Apples* found that, while the language in Article 5.1 does not require that a risk assessment be "based on" or "in conformity with" risk assessment techniques of international organizations, it suggests that "reference to these risk assessment techniques can provide very useful guidance as to whether the risk

Lastly, the term 'as appropriate to the circumstances' in SPS Article 5.1

> should not be interpreted as authorizing a risk assessor to deviate from the requirements of Articles 5.1 and 5.2 or to ignore the available scientific evidence, even where expert judgement is used. A degree of scientific uncertainty does not justify a departure from the requirements of Articles 5.1 and 5.2 and, in particular, the requirement that the available scientific evidence be taken into account in the risk assessment. Generally, documentation and transparency in the use of expert judgement are instrumental in the determination of whether the overall risk assessment, even when it is conducted in the face of some scientific uncertainty, relies on the available scientific evidence and is consistent with the *SPS Agreement*.[223]

4.4.3.2 SPS Measures 'based on' risk assessment: due process requirements?

Pursuant to SPS Article 5.1, members shall ensure that their SPS measures 'are based on an assessment of the risks to human, animal or plant life or health'. This wording seems to imply that the state taking the SPS measure would have to act *after* (that is, 'on the basis' of) having performed, in good faith, the risk assessment mandated by SPS Article 5.1. In that light, an SPS measure is not 'based on' a risk assessment, but rather base-able (or objectively justified) if *ex post facto* the measure shows that it *could have* been based on a risk assessment.

According to the Appellate Body's reading, this is *not* what the SPS Agreement requires: rather, 'based on' is interpreted as being dissociated from the entity taking the measure. On that view, the term merely defines 'a substantive requirement'[224] of the pertinent SPS measure. 'Based on', thus, does not cover how the author of the SPS measure proceeded; rather, 'based on' describes

> a certain *objective relationship* between two elements, that is to say, to an *objective situation* that persists and is observable between an SPS measure and a risk assessment. (Emphasis in the original.)[225]

Whereas the right to justify an SPS measure *ex post facto* according to new scientific insights would of course seem appropriate, as 'frozen files' are the exception and not the norm in WTO dispute settlement procedures, it appears less obvious to read 'based on' as not implying that the SPS measure had to be 'taken on the basis' of certain procedures, in particular as it is attached to the word 'assessment'. This combination would seem to tend towards a reading that *something* had to happen, some minimum procedural due process had to be followed, for the SPS measure to be in line with the obligations under the SPS Agreement.

While the Appellate Body's textual interpretation may be tenable, its result seems particularly difficult to reconcile with the context of the provision and its ultimate

assessment at issue constitutes a proper risk assessment within the meaning of Article 5.1' (Panel report, *Japan—Apples*, para. 8.241).

[223] *Australia—Apples* (Appellate Body), para. 244.

[224] *EC—Hormones* (Appellate Body), para. 193; in *Japan—Agricultural Products II*, the Appellate Body at para. 84 of its report, speaks of 'rational or objective relationship between the SPS measure and the scientific evidence.'

[225] *EC—Hormones* (Appellate Body), para. 189.

purpose: the context is not just shaped by the role of science, but rather also by the obligation to 'follow procedure' and to create a predictable environment.[226] The *purpose* is to achieve an *intended*—not just a coincidental—balance between regulatory space and avoidance of trade impediments. Thus, reading procedural due process out of 'based on' seems regrettable, for a variety or reasons. First, it is beyond doubt that the obligation to go through certain procedures (for example preparing environmental impact assessments, or trade sustainability assessments) does have considerable impact on how actors behave. Secondly, from an evidentiary perspective, it is almost impossible for uninformed parties to discern the 'basis' of an SPS measure, unless some evidence is provided. In fact, Annex B(1) obliges members to publish promptly all SPS measures 'in such a manner as to enable interested Members to become acquainted with them'. Paragraph 3 of the same Annex further obliges them to introduce enquiry points whereby interested parties can request (and obtain) responses to reasonable queries that they might have. The *EC—Hormones* Panel took that context into account. The Appellate Body allows *ex post facto* rationalizations, which seems less than the risk assessment mandated by the contracting parties to the Marrakesh Agreement demands.

4.4.3.3 Taking into account risk assessment techniques developed by the relevant international organizations

SPS Article 5.1 directs members conducting a risk assessment to take into account internationally developed risk assessment techniques. Given the preceding interpretation, that passage is largely devoid of any meaning, as the SPS Agreement—in the Appellate Body's reading—does not require to take SPS measures only *after* having performed a risk assessment. The ability to show, later (for instance to a Panel), that there is an *objective* relationship between the measure and science suffices. Clearly, internationally developed techniques will often represent an international consensus, and will thus be particularly convincing for a trier of fact and a reviewer. Hence, the Appellate Body has confirmed that the reference to internationally developed risk assessment techniques

> does not mean that a risk assessment must be based on or conform to such techniques. Nor does it imply that compliance with such techniques alone suffices to demonstrate compliance with a Member's obligations under the *SPS Agreement*. However, reference by the risk assessor to such techniques is useful both to the risk assessor, should a dispute arise in relation to the risk assessment, and to the panel that is called upon to review the consistency of that risk assessment with the provisions of the *SPS Agreement*.[227]

[226] With regard to transparency, see, for example, *EC—Approval and Marketing of Biotech Products* (Panel), paras. 7.1449–7.1465; *Japan—Agricultural Products II* (Appellate Body), paras. 102–8.

[227] *Australia—Apples* (Appellate Body), para. 246; cf. ibid. fn. 377: 'We observe that the panel in Japan—Apples found that, while the language in Article 5.1 does not require that a risk assessment be "based on" or "in conformity with" risk assessment techniques of international organizations, it suggests that "reference to these risk assessment techniques can provide very useful guidance as to whether the risk assessment at issue constitutes a proper risk assessment within the meaning of Article 5.1" (*Japan—Apples* (Panel), para. 8.241)'.

4.5 Appropriate level of protection

As indicated in the introduction to this chapter, the process to denote the level of risk that a member and its society are prepared to accept—the subjectively defined 'appropriate level of sanitary or phytosanitary protection' (ALOP) and the preparation of a suitable toolbox are often described by the term *risk management*.

Note, that this process precedes risk assessment pursuant to SPS Article 5.1 to 5.3. According to the Appellate Body the 'determination of the level of protection . . . logically precedes and is separate from the establishment or maintenance of the SPS measure',[228] which is but a tool used to implement the chosen policy.[229] A WTO member first defines its appropriate level of protection, and only then chooses the instrument that will be used to achieve the level sought:

> It can be deduced from the provisions of the *SPS Agreement* that the determination by a Member of the "appropriate level of protection" logically precedes the establishment or decision on maintenance of an "SPS measure". The provisions of the *SPS Agreement* also clarify the correlation between the "appropriate level of protection" and the "SPS measure".[230]

SPS Article 5.4 to 5.6 SPS describe the parameters for establishing the acceptable level of risk[231]

> 4. Members should, when determining the appropriate level of sanitary or phytosanitary protection, take into account the objective of minimizing negative trade effects.
>
> 5. With the objective of achieving consistency in the application of the concept of appropriate level of sanitary or phytosanitary protection against risks to human life or health, or to animal and plant life or health, each Member shall avoid arbitrary or unjustifiable distinctions in the levels it considers to be appropriate in different situations, if such distinctions result in discrimination or a disguised restriction on international trade. Members shall cooperate in the Committee, in accordance with paragraphs 1, 2 and 3 of Article 12, to develop guidelines to further the practical implementation of this provision. In developing the guidelines, the Committee shall take into account all relevant factors, including the exceptional character of human health risks to which people voluntarily expose themselves.
>
> 6. Without prejudice to paragraph 2 of Article 3, when establishing or maintaining sanitary or phytosanitary measures to achieve the appropriate level of sanitary or phytosanitary protection, Members shall ensure that such measures are not more trade-restrictive than required to achieve their appropriate level of sanitary or phytosanitary protection, taking into account technical and economic feasibility.[232]

[228] *Australia—Salmon* (Appellate Body), para. 203.
[229] Ibid. para. 200.
[230] Ibid. para. 201.
[231] See Annex A(5). Note, that it explicitly offers this term as synonymous with ALOP.
[232] [Original Footnote 3] For purposes of paragraph 6 of Article 5, a measure is not more trade-restrictive than required unless there is another measure, reasonably available taking into account technical and economic feasibility, that achieves the appropriate level of sanitary or phytosanitary protection and is significantly less restrictive to trade.

4.5.1 *Determining the appropriate level of protection*

Pursuant to SPS Article 5.4, members should have the right to determine 'the appropriate level of sanitary or phytosanitary protection'.[233] SPS Annex A(5) confirms that the '[a]ppropriate level of sanitary or phytosanitary protection' describes

> [t]he level of protection *deemed appropriate* by the Member establishing a sanitary or phytosanitary measure to protect human, animal or plant life or health within its territory. (Emphasis added.)

Each WTO member enjoys the right to determine the level of protection that it deems acceptable,[234] provided it takes into account the objective of minimizing negative trade effects.[235] However, the members' vast margin of appreciation only extends to the *content* of that determination, which may well include the possibility to set a *zero risk* level:[236]

> [T]he "risk" evaluated in a risk assessment must be an ascertainable risk; theoretical uncertainty is "not the kind of risk which, under Article 5.1, is to be assessed." This does not mean, however, that a Member cannot determine its own appropriate level of protection to be "zero risk".[237]

With regard to the determination as such, the Appellate Body starts from the assumption that the SPS impliedly imposes an 'obligation to determine the appropriate level of protection', which must be sufficiently precise and unequivocal.[238] Otherwise the application of the relevant provisions of the SPS Agreement would be rendered ineffective. Whereas the state is not obliged to determine in quantitative terms the level of protection,[239]

> [t]his does not mean, however, that an importing Member is free to determine its level of protection with such vagueness or equivocation that the application of the relevant provisions of the *SPS Agreement*, such as Article 5.6, becomes impossible. It would obviously be wrong to interpret the *SPS Agreement* in a way that would render nugatory entire articles or paragraphs of articles of this Agreement and allow Members to escape from their obligations under this Agreement.[240]

[233] SPS Art. 5.4 only adds, that members '*should*. . . take into account the objective of minimizing negative trade effects' (emphasis added); hence this does not constitute a condition, but rather a recommendation.

[234] *Australia—Salmon* (Appellate Body), para. 199 speaks of 'prerogative'.

[235] cf. Gabrielle Marceau and Joel Trachtman, 'Responding to National Concerns' in Daniel Bethlehem, Donald McRae, Rodney Neufeld, and Isabelle Van Damme, eds., *Oxford Handbook of International Trade Law* (Oxford University Press, 2009) 219.

[236] Probably illusory in the light of the bounded rationality within which humans operate.

[237] *Australia—Salmon* (Appellate Body), para. 125, referring to *EC—Hormones* (Appellate Body), para. 186.

[238] *Australia—Salmon* (Appellate Body), para. 206; *US/Canada—Continued Suspension* (Appellate Body), para. 523.

[239] *Australia—Salmon* (Appellate Body), para. 206; *US/Canada—Continued Suspension* (Appellate Body), para. 523.

[240] *Australia—Salmon* (Appellate Body), para. 206.

Therefore, Panels may exceptionally draw inferences from the instruments used, if the member concerned has not established its level protection or 'does so with insufficient precision'.[241]

4.5.2 Consistency in the application of the appropriate level of protection

According to SPS Article 5.5,

> each Member shall avoid arbitrary or unjustifiable distinctions in the levels it considers to be appropriate in different situations, if such distinctions result in discrimination or a disguised restriction on international trade.[242]

SPS Article 5.5 forces complainants on a more 'complex and indirect route' than the more straightforward non-discrimination provision of SPS Article 2.3, as it requires consistency regarding the ALOP *across* situations. This is a rather unique standard in WTO (non-)discrimination law.

In its report on *EC—Hormones*, the Appellate Body established a three-pronged test that a complaining party must satisfy in order to establish a violation of SPS Article 5.5:

- The first element is that the Member imposing the disputed measure complained of has adopted its own appropriate levels of sanitary protection against risks to human life or health in several different situations.
- The second element to be shown is that those *levels of protection* exhibit arbitrary or unjustifiable differences ('distinctions' in the language of Article 5.5) in their treatment of different situations.
- The last element requires that the arbitrary or unjustifiable differences result in discrimination or a disguised restriction of international trade. We understand the last element to be referring to the *measure* embodying or implementing a particular level of protection as resulting, in its application, in discrimination, or a disguised restriction on international trade. (Emphasis in the original.)[243]

Note, that a successful complaint needs to show all three elements of that test.

> The presence of the second element—the arbitrary or unjustifiable character of differences in *levels of protection* considered by a Member as appropriate in differing situations—may in practical effect operate as a "warning" signal that the implementing *measure* in its application *might* be a discriminatory measure or *might* be a restriction on international trade disguised as an SPS measure for the protection of human life or health. Nevertheless, the measure itself needs to be examined and

[241] Ibid. para. 207.

[242] With regard to the goal of 'achieving consistency in the application of the concept of appropriate level of sanitary or phytosanitary protection', see *EC—Hormones* (Appellate Body), para. 213: 'the statement of that goal does not establish a *legal obligation* of consistency of appropriate levels of protection. We think, too, that the goal set is not absolute or perfect consistency, since governments establish their appropriate levels of protection frequently on an *ad hoc* basis and over time, as different risks present themselves at different times. It is only arbitrary or unjustifiable inconsistencies that are to be avoided.'

[243] *EC—Hormones* (Appellate Body), para. 214.

> appraised and, in the context of the differing levels of protection, shown to result in discrimination or a disguised restriction on international trade.[244]

To perform this test, however, the complaining party first needs to establish comparability across situations:

> If the situations proposed to be examined are *totally* different from one another, they would not be rationally comparable and the differences in levels of protection cannot be examined for arbitrariness. (Emphasis in the original.)[245]

Thus, the situations need to 'present some common element or elements sufficient to render them comparable'.[246] In *Australia—Salmon*, the Appellate Body was somewhat more specific:

> [S]ituations can be compared under Article 5.5 if these situations involve *either* a risk of entry, establishment or spread of the same or a similar disease, *or* a risk of the same or similar "associated potential biological and economic consequences."[247]
>
> [F]or situations to be comparable under Article 5.5, it is sufficient for these situations to have in common a risk of entry, establishment or spread of *one* disease of concern. There is no need for these situations to have in common a risk of entry, establishment or spread of *all* diseases of concern.[248]

But having met the threshold of comparability does not suffice for a claim based on SPS Article 5.5: neither the letter nor the spirit of that provision require WTO members to provide uniformity across the various ALOPs that they pursue. Therefore, SPS Article 5.5 addresses explicitly only arbitrary or unjustifiable distinctions.[249]

With regard to the last element of the SPS Article 5.5 test ('requires that the arbitrary or unjustifiable differences result in discrimination or a disguised restriction of international trade') the Appellate Body established yet another test, the elements of which are only indicative ('warning signals'):[250] substantial difference in the level of protection,[251] the arbitrary character of the differences in the level of protection, and/or the violation of SPS Article 5.1[252] serve as warning signals.

> [T]he degree of difference, or the extent of the discrepancy, in the levels of protection, is only one kind of factor which, along with others, may cumulatively lead to the conclusion that discrimination or a disguised restriction on international trade in fact results from the application of a measure or measures embodying one or more of those different levels of protection. . . . It is well to bear in mind that, after all, the difference in levels of protection that is characterizable as arbitrary or unjustifiable is only an element of (indirect) proof that a Member may actually be applying an SPS measure in a manner that discriminates between Members or constitutes a disguised

[244] Ibid. para. 215; see also *Australia—Salmon* (Appellate Body), para. 162 *et seq*.
[245] *EC—Hormones* (Appellate Body), para. 217. [246] Ibid. para. 217.
[247] *Australia—Salmon* (Appellate Body), para. 146.
[248] Ibid. para. 152; See also *EC—Hormones* (Appellate Body), para. 217.
[249] *EC—Hormones* (Appellate Body), para. 213.
[250] *Australia—Salmon* (Appellate Body), para. 162 *et seq*.
[251] Ibid. para. 164. [252] Ibid. para. 166.

> restriction on international trade, prohibited by the basic obligations set out in Article 2.3 of the *SPS Agreement*.[253] (Italics in the original.)

The Appellate Body tends to focus on a case-by-case evaluation, rather than providing a benchmark for future Panels. In *Australia—Salmon*, however, it casts the net quite wide. Comparability across risks might cover dozens of situations: should France, for example, in the *EC—Asbestos* case (assuming it had been dealt under the SPS Agreement) be accused of being inconsistent (and thus, in violation of SPS Article 5.5) because, on the one hand, it took measures banning sales of asbestos-containing construction material but, on the other, did nothing to stop sales of cigarettes? Both items (asbestos-containing construction material and cigarettes) are health-impairing. Both might contribute to the same disease. It could be that the risk distribution in both cases is more or less comparable. And it could further be that France produces cigarettes but no asbestos-containing construction material. But is this enough to find 'that discrimination or a disguised restriction on international trade in fact results from the application of a measure or measures embodying one or more of those different levels of protection'? Casting the net wide allows WTO Panels to become the judges of consistency in the formulation of national health policies. The risk of false positives by the WTO adjudicating bodies in the field of health-related matters is not comparable, from either a human or an institutional perspective, to the risk of false positives, say in the field of antidumping. Therefore, some authors[254] have proposed that the consistency requirement in SPS Article 5.5 should be confined to a review of measures aimed to address health and environmental considerations in a given relevant product market. This reading of the consistency requirement is eminently contextual: WTO members that are consistent in the application of a level of protection in a given relevant product market can hardly be accused of using SPS measures in order to provide a regulatory subsidy to their competing national industry.

4.5.3 Necessity of the SPS measure with regard to the ALOP

Pursuant to SPS Article 5.6:

> Members shall ensure that such measures are not more trade-restrictive than required to achieve their appropriate level of sanitary or phytosanitary protection, taking into account technical and economic feasibility.

As already discussed, measures conforming to an international standard are presumed to be in conformity with the necessity requirement.[255] A footnote to SPS Article 5.6 further specifies:

[253] *EC—Hormones* (Appellate Body), para. 240.

[254] Henrik Horn and Petros Mavroidis, 'National Health Regulations and the SPS Agreement: The WTO Case-law of the Early Years' in Thomas Cottier and Petros Mavroidis, eds., *The Role of the Judge in International Trade Regulation* (University of Michigan Press, 2003), n. 213 at 255–86.

[255] SPS Art. 3.2: 'Sanitary or phytosanitary measures which conform to international standards, guidelines or recommendations shall be deemed to be necessary to protect human, animal or plant life or health, and presumed to be consistent with the relevant provisions of this Agreement and of GATT 1994.'

> For purposes of paragraph 6 of Article 5, a measure is not more trade-restrictive than required unless there is another measure, reasonably available taking into account technical and economic feasibility, that achieves the appropriate level of sanitary or phytosanitary protection and is significantly less restrictive to trade.

The Appellate Body established a three-pronged test to establish a violation of SPS Article 5.6:

> According to the footnote to Article 5.6, a measure is considered more trade-restrictive than required if there is another SPS measure which:
>
> (1) is reasonably available taking into account technical and economic feasibility;
>
> (2) achieves the Member's appropriate level of protection; and
>
> (3) is significantly less restrictive to trade than the SPS measure contested.[256]

It is up to the complainant to establish 'a *prima facie* case that there is an alternative measure that meets all three elements under Article 5.6'.[257] With regard to the second element, the Appellate Body demands from the complaining party to

> (i) identify the level of protection that [Member taking the SPS measure] has set as its appropriate level;
>
> (ii) determine what level of protection would be achieved by [the complainant's] alternative measure; and
>
> (iii) determine whether the level of protection that would be achieved by the alternative measure would satisfy [the Member's taking the SPS measure] appropriate level of protection.[258]

4.6 The precautionary principle and the SPS Agreement

4.6.1 The precautionary principle in the WTO and in customary international law

WTO members can provisionally adopt SPS measures in the absence of scientific backing,[259] pursuant to SPS Article 5.7, which reads:

> In cases where relevant scientific evidence is insufficient, a Member may provisionally adopt sanitary or phytosanitary measures on the basis of available pertinent information, including that from the relevant international organizations as well as from sanitary or phytosanitary measures applied by other Members. In such circumstances, Members shall seek to obtain the additional information necessary for a more

[256] *Japan—Agricultural Products II* (Appellate Body), para. 95, referring to *Australia—Salmon* (Appellate Body), para. 194; see also *Australia—Apple* (Appellate Body), para. 363. As to the relationship to SPS Art. 5.1, see *Australia—Apple* (Appellate Body), para. 354.

[257] *Japan—Agricultural Products II* (Appellate Body), para. 126.

[258] *Australia—Apple* (Appellate Body), para. 368, line breaks added.

[259] *Japan—Agricultural Products II* (Appellate Body), paras. 80, 89, and 91; *US/Canada—Continued Suspension* (Appellate Body), paras. 676–9 and fn. 1398; *EC—Approval and Marketing of Biotech Products* (Panel), paras. 7.2923–7.3007; cf. Andrew Lang, 'Provisional Measures Under Article 5.7 of the WTO's Agreement on Sanitary and Phytosanitary Measures: Some Criticisms of the Jurisprudence So Far' (2008) *Journal of World Trade* 42, 1085–106.

> objective assessment of risk and review the sanitary or phytosanitary measure accordingly within a reasonable period of time.

According to the Appellate Body, SPS Article 5.7 does not explicitly refer to the precautionary principle, but 'reflects' it:[260]

> The precautionary principle is regarded by some as having crystallized into a general principle of customary international *environmental* law. Whether it has been widely accepted by Members as a principle of *general* or *customary international law* appears less than clear. We consider, however, that it is unnecessary, and probably imprudent, for the Appellate Body in this appeal to take a position on this important, but abstract, question....
>
> It appears to us important, nevertheless, to note some aspects of the relationship of the precautionary principle to the *SPS Agreement*. First, the principle has not been written into the *SPS Agreement* as a ground for justifying SPS measures that are otherwise inconsistent with the obligations of Members set out in particular provisions of that Agreement. Secondly, the precautionary principle indeed finds reflection in Article 5.7 of the *SPS Agreement*.... [T]here is no need to assume that Article 5.7 exhausts the relevance of a precautionary principle. It is reflected also in the sixth paragraph of the preamble and in Article 3.3. These explicitly recognize the right of Members to establish their own appropriate level of sanitary protection, which level may be higher (i.e., more cautious) than that implied in existing international standards, guidelines and recommendations. Thirdly, a panel charged with determining, for instance, whether "sufficient scientific evidence" exists to warrant the maintenance by a Member of a particular SPS measure may, of course, and should, bear in mind that responsible, representative governments commonly act from perspectives of prudence and precaution where risks of irreversible, e.g. life-terminating, damage to human health are concerned. Lastly, however, the precautionary principle does not, by itself, and without a clear textual directive to that effect, relieve a panel from the duty of applying the normal (i.e. customary international law) principles of treaty interpretation in reading the provisions of the *SPS Agreement*.[261]

SPS Article 5.7 sets out four obligations: the first two have to be met when a provisional SPS measure is adopted, whereas the others relate to maintaining the provisional SPS measure in force. These four obligations are:

(1) [the measure is] imposed in respect of a situation where 'relevant scientific information is insufficient';
(2) [the measure is] adopted 'on the basis of available pertinent information';
(3) [the Member that adopted the measure] 'seek[s] to obtain the additional information necessary for a more objective assessment of risk'; and
(4) [the Member that adopted the measure] 'review[s] the ... measure accordingly within a reasonable period of time.'[262]

[260] *EC—Hormones* (Appellate Body), para. 124.
[261] *EC—Hormones* (Appellate Body), paras. 123, 124; see also *US—Continued Suspension/Canada—Continued Suspension* (Appellate Body), para. 680.
[262] *US/Canada—Continued Suspension* (Appellate Body), para. 676, referring to *Japan—Agricultural Products II* (Appellate Body), para. 89.

We shall address first the obligations pertinent at the time of the adoption, then those relevant for keeping a provisional SPS measure under SPS Article 5.7 WTO-compatible.

4.6.2 SPS measures adopted as a precaution

Article 5.7 does not override the provisions of SPS Article 5.1 and 5.2; rather it only allows the provisional adoption of SPS measures in the absence of sufficient scientific evidence.[263]

> Article 5.7 operates as a *qualified* exemption from the obligation under Article 2.2 not to maintain SPS measures without sufficient scientific evidence. An overly broad and flexible interpretation of that obligation would render Article 5.7 meaningless. (Emphasis in the original.)[264]

In *Japan—Apples*, the Appellate Body went one step further and clarified its understanding of the relationship between the exception (SPS Article 5.7) and the science-based standard operating procedure (SPS Articles 5.1, 5.2, and 2.2). In its view, if science is well settled on an issue, recourse to precaution is unwarranted.

> The application of Article 5.7 is triggered not by the existence of scientific uncertainty, but rather by the insufficiency of scientific evidence. The text of Article 5.7 is clear: it refers to "cases where relevant scientific evidence is insufficient", not to "scientific uncertainty". The two concepts are not interchangeable. Therefore, we are unable to endorse Japan's approach of interpreting Article 5.7 through the prism of "scientific uncertainty".[265]

In *US/Canada—Continued Suspension*, the Appellate Body restated its reading of SPS Article 5.7, according to which the provision's four conditions must be interpreted with a view to the recognition of the precautionary principle:[266]

> [A] panel charged with determining, for instance, whether "sufficient scientific evidence" exists to warrant the maintenance by a Member of a particular SPS measure may, of course, and should, bear in mind that responsible, representative governments commonly act from the perspectives of prudence and precaution where risks of irreversible, e.g. life-terminating, damage to human health are concerned.[267]

But science can sometimes persuasively point to a direction and sometimes not. Reacting to some of the criticism voiced in this context, the Appellate Body, in a more recent report, tried to answer some of the concerns relating to the relationship between precaution and scientific evidence, and between uncertainty and certainty:

[263] See *Japan—Apples* (Appellate Body), paras. 179, 184; *US/Canada—Continued Suspension* (Appellate Body), paras. 674, 677, 681, 694–7, 701–3, 705, 708, 710–11, 721, and 725–6.
[264] *Japan—Agricultural Products II* (Appellate Body), para. 80.
[265] *Japan—Apples* (Appellate Body), para. 184.
[266] *EC—Hormones* (Appellate Body), para. 124.
[267] *US/Canada—Continued Suspension* (Appellate Body), para. 680 referring to *EC—Hormones* (Appellate Body), para. 124.

Under Article 2.2 of the *SPS Agreement*, WTO Members are required to "ensure that any sanitary or phytosanitary measure is applied only to the extent necessary to protect human, animal or plant life or health, is based on scientific principles and is not maintained without sufficient scientific evidence, except as provided for in paragraph 7 of Article 5." This requirement is made operative in other provisions of the *SPS Agreement*, including Article 5.1, which requires SPS measures to be "based on" a risk assessment. At the same time, Article 2.2 excludes from its scope of application situations in which the relevant scientific evidence is insufficient. In such situations, the applicable provision is Article 5.7 of the *SPS Agreement*. Thus, the applicability of Articles 2.2 and 5.1, on the one hand, and of Article 5.7, on the other hand, will depend on the sufficiency of the scientific evidence. The Appellate Body has explained that the relevant scientific evidence will be considered "insufficient" for purposes of Article 5.7 "if the body of available scientific evidence does not allow, in quantitative or qualitative terms, the performance of an adequate assessment of risks as required under Article 5.1 and as defined in Annex A to the *SPS Agreement*." This means that where the relevant scientific evidence is sufficient to perform a risk assessment, as defined in Annex A of the *SPS Agreement*, a WTO Member may take an SPS measure only if it is "based on" a risk assessment in accordance with Article 5.1 and that SPS measure is also subject to the obligations in Article 2.2. If the relevant scientific evidence is insufficient to perform a risk assessment, a WTO Member may take a provisional SPS measure on the basis provided in Article 5.7, but that Member must meet the obligations set out in that provision. . . .

Thus the existence of scientific controversy in itself is not enough to conclude that the relevant scientific evidence is "insufficient". It may be possible to perform a risk assessment that meets the requirements of Article 5.1 even when there are divergent views in the scientific community in relation to a particular risk. By contrast, Article 5.7 is concerned with situations where deficiencies in the body of scientific evidence do not allow a WTO Member to arrive at a sufficiently objective conclusion in relation to risk. When determining whether such deficiencies exist, a Member must not exclude from consideration relevant scientific evidence from any qualified and respected source. Where there is, among other opinions, a qualified and respected scientific view that puts into question the relationship between the relevant scientific evidence and the conclusions in relation to risk, thereby not permitting the performance of a sufficiently objective assessment of risk on the basis of the existing scientific evidence, then a Member may adopt provisional measures under Article 5.7 on the basis of that qualified and respected view.

WTO Members' right to take provisional measures in circumstances where the relevant scientific information is "insufficient" is also subject to the requirement that such measures be adopted "on the basis of available pertinent information". Such information may include information from "the relevant international organizations" or deriving from SPS measures applied by other WTO Members. Thus, Article 5.7 contemplates situations where there is some evidentiary basis indicating the possible existence of a risk, but not enough to permit the performance of a risk assessment. Moreover, there must be a rational and objective relationship between the information concerning a certain risk and a Member's provisional SPS measure. In this sense, Article 5.7 provides a "temporary 'safety valve' in situations where some

> evidence of a risk exists but not enough to complete a full risk assessment, thus making it impossible to meet the more rigorous standards set by Articles 2.2 and 5.1".[268]

Science 'continuously evolves'[269] and therefore no 'critical mass' of scientific evidence is required.[270]

> It may be useful to think of the degree of change as a spectrum. On one extreme of this spectrum lies the incremental advance of science. Where these scientific advances are at the margins, they would not support the conclusion that previously sufficient evidence has become insufficient. At the other extreme lie the more radical scientific changes that lead to a paradigm shift. Such radical change is not frequent. Limiting the application of Article 5.7 to situations where scientific advances lead to a paradigm shift would be too inflexible an approach. WTO Members should be permitted to take a provisional measure where new evidence from a qualified and respected source puts into question the relationship between the pre-existing body of scientific evidence and the conclusions regarding the risks. We are referring to circumstances where new scientific evidence casts doubts as to whether the previously existing body of scientific evidence still permits of a sufficiently objective assessment of risk.[271]

4.6.3 Maintaining provisional SPM measures based on SPS Article 5.7

SPS Article 5.7, second sentence requires members to supplement the factual basis of a provisional SPS measure they chose to take, with 'additional information necessary for a more objective assessment of risk', in order for the SPS measure to remain compatible with the science-based approach of the SPS Agreement. Importantly, this has to happen within a 'reasonable period of time'. This obligation 'highlight[s] the *provisional* nature of measures adopted pursuant to Article 5.7'.[272] Without such obligation to improve the as such insufficient scientific basis,

> the provisional nature of measures taken pursuant to Article 5.7 would lose meaning. The "insufficiency" of the scientific evidence is not a perennial state, but rather a transitory one, which lasts only until such time as the imposing Member procures the additional scientific evidence which allows the performance of a more objective assessment of risk.[273]

Despite the lack of 'explicit prerequisites regarding the additional information to be collected or a specific collection procedure',[274] the Appellate Body has interpreted the obligation of the user of a provisional SPS measure to include the duty 'to identify the insufficiencies in the relevant scientific evidence, and the steps that it intends to take to obtain the additional information that will be necessary to address these deficiencies in

[268] *US/Canada—Continued Suspension* (Appellate Body), paras. 674, 677, and 678.
[269] *US—Continued Suspension* (Panel), para. 7.645.
[270] *US/Canada—Continued Suspension* (Appellate Body), para. 705.
[271] Ibid. para. 703.
[272] *Japan—Apples* (Appellate Body), para. 176, fn. 318; *US/Canada—Continued Suspension* (Appellate Body), para. 674.
[273] *US/Canada—Continued Suspension* (Appellate Body), para. 679.
[274] *Japan—Agricultural Products II* (Appellate Body), para. 92.

order to make a more objective assessment and review the provisional measure within a *reasonable period of time*.'[275]

> The additional information to be collected must be "germane" to conducting the assessment of the specific risk. A Member is required under Article 5.7 to seek to obtain additional information but is not expected to guarantee specific results. Nor is it expected to predict the actual results of its efforts to collect additional information at the time when it adopts the SPS measure. Finally, the Member taking the provisional SPS measure must review it within a reasonable period of time.[276] . . .
>
> In emergency situations, for example, a WTO Member will take a provisional SPS measure on the basis of limited information and the steps it takes to comply with its obligations to seek to obtain additional information and review the measure will be assessed in the light of the exigencies of the emergency.[277]

With regard to the relationship between SPS Article 5.1 and Article 5.7, the Appellate Body explained, that while situations may exist

> where the relevant scientific evidence is sufficient to perform a risk assessment, a WTO Member performs such a risk assessment, but does not adopt an SPS measure either because the risk assessment did not confirm the risk, or the risk identified did not exceed that Member's chosen level of protection. Also, there may be situations where there is no pertinent scientific information available indicating a risk such that an SPS measure would be unwarranted even on a provisional basis.[278]

The duration of the reasonable period of time obviously has to be interpreted in light of the specific circumstances of each and every case.[279]

4.7 Selected other provisions of the SPS Agreement

4.7.1 Recognition of foreign SPS policy and measures

Regardless of the long-term goal of harmonization, SPS policies and measures in the WTO's 161 members vary considerably. This may lead to considerable trade impediments: low tariffs and national treatment may mean less, if and when facilitated market access is only granted after time-consuming and costly tests that may already have taken place in the home country pursuant to a slightly different standard. To avoid such double burden for the foreign product, SPS Article 4 requests that members ('shall') accept the SPS measures of fellow WTO members as

> equivalent, even if these measures differ from their own or from those used by other Members trading in the same product, if the exporting Member objectively demonstrates to the importing Member that its measures achieve the importing Member's appropriate level of sanitary or phytosanitary protection.

[275] *US/Canada—Continued Suspension* (Appellate Body), para. 675. [276] Ibid. para. 679.
[277] Ibid. para. 680. [278] Ibid. para. 681.
[279] *Japan—Agricultural Products II* (Appellate Body), para. 93.

A lengthy decision of the SPS Committee[280] addresses how importing and exporting members put life into the obligation of granting the importing state access to the exporting state's inspection, testing, and other relevant procedures, and the rather soft undertaking to 'enter into consultations with the aim of achieving bilateral and multilateral agreements on recognition of the equivalence'.[281] Note, that if such an agreement is concluded, the ensuing result is not insulated from the SPS Agreement's non-discrimination clauses.[282] WTO members not parties to an agreement establishing equivalence should benefit from its extension, if they can show that their regulatory framework sufficiently addresses the concerns of the contracting parties to the MRA.

4.7.2 Adaptation to regional conditions, including pest- or disease-free areas and areas of low pest or disease prevalence

SPS Article 6 is a specific manifestation of the general principle enshrined in the SPS Agreement according to which members should only take the measures *necessary* to ensure the maintenance of their ALOP. It reads in relevant parts:

> 1. Members shall ensure that their sanitary or phytosanitary measures are adapted to the sanitary or phytosanitary characteristics of the area—whether all of a country, part of a country, or all or parts of several countries—from which the product originated and to which the product is destined. In assessing the sanitary or phytosanitary characteristics of a region, Members shall take into account, *inter alia*, the level of prevalence of specific diseases or pests, the existence of eradication or control programmes, and appropriate criteria or guidelines which may be developed by the relevant international organizations.

Note that SPS Article 6.1 addresses both the areas *from which* the product originated and *to which* the product is destined, regardless of the legal status of that territorial space ('whether all of a country, part of a country, or all or parts of several countries'). Also, the wording of the obligation to recognize the concepts of pest- or disease-free areas and areas of low pest or disease prevalence (SPS Article 6.2) seems to address both importing and exporting members. Thus, arguably, SPS Article 6.1 imposes on the SPS measure-taking state not only the duty to adapt the measure to the situation of the exporter, but also to take into account the particularities of the country of destination. An importing country in which certain risks exist for some parts of the national territory, but not for others, may therefore have to consider allowing differentiated access for the purpose of reducing the impact for its trading partners. For instance, whereas a certain pest affiliated with certain agricultural products from Brazil, may be dangerous for Florida citrus fruit growers, no such risk may exist for the territory of

[280] Decision on the Implementation of Article 4 of the Agreement on the Application of SPS Measures (Equivalence) of 23 July 2004, WTO Doc. G/SPS/19/Rev.2, reprinted in Committee on Sanitary and Phytosanitary Measures, Major decisions and documents, WTO: Geneva, September 2011, <http://www.wto.org/english/tratop_e/sps_e/decisions06_e.htm>. For an analysis of the Decision see *US—Poultry (China)* (Panel), paras. 7.134–7.137.

[281] SPS Art. 4.2.

[282] See also the *obiter dictum* in *US—Poultry (China)* (Panel), paras. 7.136, 7.138, and 7.139.

Alaska, as there is no citrus fruit production there and the state is geographically distant from Florida. In fact any member with a significant landmass (for example, Australia, Canada, Russia, or the United States) may be in such a situation, depending on the circumstances of the case. Clearly such an interpretation would also serve the purpose of taking only those measures necessary to protect the legitimate interests manifested in the ALOP.

In 2008, the SPS Committee issued non-binding guidelines to facilitate 'the practical implementation of Article 6 by improving transparency, exchange of information, predictability, confidence and credibility between importing and exporting Members.'[283]

4.7.3 *Control inspection and approval procedures*

Members have control, inspection, and approval procedures in place in order to enforce the SPS policies that they established. SPS Article 8 requests that members follow SPS Annex C, which reads in relevant parts:

> 1. Members shall ensure, with respect to any procedure to check and ensure the fulfilment of sanitary or phytosanitary measures, that:
>
> (a) such procedures are undertaken and completed *without undue delay* and *in no less favourable manner for imported products than for like domestic products*;
>
> (b) the standard processing period of each procedure is *published* or that the anticipated processing period is *communicated to the applicant* upon request; when receiving an application, the competent body *promptly* examines the completeness of the documentation and *informs the applicant in a precise and complete manner* of all deficiencies; the competent body transmits *as soon as possible* the results of the procedure in a *precise and complete* manner to the applicant so that corrective action may be taken if necessary; even when the application has deficiencies, the competent body proceeds as far as practicable with the procedure if the applicant so requests; and that upon request, the applicant is informed of the stage of the procedure, with any delay being explained; . . . (Emphasis added.)

The remainder of Annex C contains further obligations that ensure transparency, procedural and substantive due process, fair and equitable procedures, and administrative reasonableness; so far, only the terms 'without undue delay' and 'in no less favourable manner' have received the attention of the Appellate Body and a Panel.[284]

4.7.4 *Procedural obligations*

Pursuant to SPS Article 7, members are obliged to notify changes in their SPS measures and to provide pertinent information in accordance with the provisions of Annex B to

[283] WTO Doc. G/SPS/48, 16 May 2008, Guidelines to Further the Practical Implementation of Article 6 of the Agreement on the Application of Sanitary and Phytosanitary Measures, available at <http://www.wto.org/english/tratop_e/sps_e/decisions06_e.htm>.

[284] With regard to 'without undue delay' cf. *Australia—Apples* (Appellate Body), para. 437; *EC—Approval and Marketing of Biotech Products* (Panel), para. 7.1511 *et seq.*; also *EC—Approval and Marketing of Biotech Products* (Panel), para. 7.2400 *et seq.*

the SPS. To this effect, Annex B(1) requires that all sanitary and phytosanitary regulations (such as laws, decrees, or ordinances) be published; other provisions of the Annex require the establishment of enquiry points and lay down specific procedures to be followed. In its report on *Japan—Agricultural Products II*, the Appellate Body opined that the listed instruments were 'not exhaustive in nature',[285] due to the function to ensure full transparency for the benefit of affected states.[286]

In practice, the notification of SPS measures pursuant to Annex B(5) and (7) is both common and of the utmost importance, as it allows exporters, regardless whether they view the SPS measure as WTO-incompatible or not, to reduce or stop shipments of agricultural exports and thereby reduce the economic losses entailed by SPS measures of importing markets. The 'chapeau' of Annex B(5) reflects this by making prior notifications mandatory, if the measure may 'have a significant effect on trade of other Members'.[287] Nevertheless, whereas SPS measures are commonly notified, the timeliness of the notifications is regularly in dispute.

Notifications can now be submitted online;[288] further facilitations were agreed upon in a decision by the SPS Committee on 'Recommended Procedures for Implementing the Transparency Obligations of the SPS Agreement (Article 7)'.[289]

Another important right in this context is the possibility to request an explanation of the reasons for specific SPS measures, if there are grounds for assuming that they are 'constraining, or [have] the potential to constrain' its pertinent exports, provided the measure is not 'legitimized' by being based on relevant international standards (SPS Article 5.8).

4.7.5 Special and differential treatment

Pursuant to SPS Article 10.1, developed country members of the WTO must 'take account of the special needs' of developing and least-developed country members with regard to the preparation and application of SPS measures. While SPS Article 10.1 contains an unconditional obligation, the latter is limited to 'taking into account' the special needs of developing countries, not necessarily to 'satisfy' them. Hence, *EC—Biotech* rightly allowed the weighing and balancing of that interest with other legitimate interests. A successful claim based on SPS Article 10.1 will require the difficult task of showing that the developed country member a priori disregarded the special needs of a developing partner.[290]

As SPS measures are of great interest to developing countries, the invitation of SPS Article 10.2 to allow, whenever possible, longer time-frames for compliance 'on products of interest to developing country Members so as to maintain opportunities for their exports' is highly relevant. SPS Article 10.3 allows the SPS Committee to grant

[285] *Japan—Agricultural Products II* (Appellate Body), paras. 105, 107 *et seq.* [286] Ibid. para. 106.

[287] *Japan—Apples* (Panel), para. 8.314.

[288] WTO Doc. G/SPS/7/Rev.3, Committee on Sanitary and Phytosanitary Measures, Recommended Procedures for Implementing the Transparency Obligations of the SPS Agreement (Article 7) as of 1 December 2008, 10.

[289] Ibid.

[290] See also *EC—Approval and Marketing of Biotech Products* (Panel), paras. 7.1620–7.1625.

developing country members 'time-limited exceptions' from obligations under the SPS Agreement, 'taking into account their financial, trade and development needs' in order to facilitate compliance. This is reflected by the Doha Ministerial Declaration's call for granting additional time between the enactment of a measure and its entry into force so that foreign producers can adjust to the new regulatory reality and not be caught by surprise.[291] In 2004–09, the SPS Committee decided on a 'Procedure to Enhance Transparency of Special and Differential Treatment in Favour of Developing Country Members', pursuant to which WTO members should allow for at least a sixty-day period between proposal of an SPS measure and implementation, in order to allow consideration of comments.[292]

4.8 Institutional provisions

Pursuant to SPS Article 12.1, a Committee on Sanitary and Phytosanitary Measures (SPS Committee) has been established. It is composed of representatives of all members wishing to participate.[293] It meets when requested, although it must meet at least three times a year (whereas the TBT Committee only needs to meet once a year, indicating the increased practical need for transparency in the field of agricultural trade). It is a much used forum for discussion and informal dispute resolution in which specific SPS measures and trade concerns are being addressed and settled.[294]

4.9 Dispute settlement provisions

4.9.1 Recourse to experts

A special feature of the SPS Agreement is the recourse to experts during adjudication. Complaints regarding SPS measures usually involve scientific or technical issues and adjudicators are well advised and, pursuant to SPS Article 11.2,

> *should* seek advice from experts chosen by the panel in consultation with the parties to the dispute. To this end, the panel may, when it deems it appropriate, establish an

[291] See WTO Doc. WT/MIN (01)/17 of 20 November 2001 which calls, in principle, for a six-month period between adoption of an SPS measure and its entry into force (that is, this period is applicable to measures that have already been *decided*). For proposals discussed during the Round, see WTO Doc. G/SPS/35, 7 July 2005, Committee on Sanitary and Phytosanitary Measures Report on Proposals for special and differential treatment.

[292] WTO Doc. G/SPS/33 Rev.1, 18 December 2009 (revising G/SPS/33 of 2 November 2004), Committee on Sanitary and Phytosanitary Measures Procedure to Enhance Transparency of Special and Differential Treatment in favour of developing country Members, Decision by the Committee (Revision).

[293] Not the least due to the mandate of SPS Art. 12.3 ('The Committee shall maintain close contact with the relevant international organizations in the field of sanitary and phytosanitary protection, especially with the Codex Alimentarius Commission, the International Office of Epizootics, and the Secretariat of the International Plant Protection Convention, with the objective of securing the best available scientific and technical advice for the administration of this Agreement and in order to ensure that unnecessary duplication of effort is avoided'), representatives of the 'three sister organizations' (Codex, OIE, IPPC) and the International Standards Organization (ISO) are taking part in the Committee's work as observers, together with the representatives of WHO and UNCTAD.

[294] See WTO Doc. G/SPS/GEN/204/Rev.15, 24 February 2015, *Specific Trade Concerns*, Note by the Secretariat, Revision.

> advisory technical experts group, or consult the relevant international organizations, at the request of either party to the dispute or on its own initiative. (Emphasis added.)

In the context of the SPS Agreement, outside expertise has been sought in each and every dispute by SPS Panels. For instance, in the *EC—Hormones* litigation, the Panel first asked parties to the dispute to name one expert each. It then named two experts (from the list prepared by the Codex Commission and the International Agency for Research on Cancer) and one additional expert in the area of carcinogenic effects of hormones.[295] The European Community appealed the fact that one of the experts was a national of a party or third party and had links with the pharmaceutical industry. The Appellate Body dismissed the EC argument and held that:

> once the panel has decided to request the opinion of individual scientific experts, there is no legal obstacle to the panel drawing up, in consultation with the parties to the dispute, ad hoc rules for those particular proceedings.[296]

Panels, it appears, will not infrequently seek expertise from outside sources following suggestions by the organizations mentioned in the SPS (OIE, IPCC, Codex). In the *Australia—Salmon* case, the Panel chose four experts after consultation with the Office International des Epizooties (OIE).[297] In the *Japan—Agricultural Products II* dispute, the Panel chose three experts after soliciting suggestions from the Secretariat of the International Plant Protection Convention.[298] Panels may also allow the parties to name experts, as in the *EC—Hormones* litigation, where the parties were given the opportunity to name one expert each.[299]

4.9.2 Functions of adjudicators vs. functions of experts

Clearly, Panels are not bound by the expertise provided. Other than that, many questions exist both in theory, and, more importantly in practice, as to the role of experts:

> A panel may and should rely on the advice of experts in reviewing a WTO Member's SPS measure, in accordance with Article 11.2 of the *SPS Agreement* and Article 13.1 of the DSU. In doing so, however, a panel must respect the due process rights of the parties. Moreover, a panel may not rely on the experts to go beyond its limited mandate of review. The purpose of a panel consulting with experts is not to perform its own risk assessment. The role of the experts must reflect the limited task of a panel. The panel may seek the experts' assistance in order to identify the scientific basis of the SPS measure and to verify that this scientific basis comes from a qualified and respected source, irrespective of whether it represents minority or majority scientific views. It may also rely on the experts to review whether the reasoning articulated on the basis of the scientific evidence is objective and coherent, and whether the particular conclusions drawn by the Member assessing the risk find sufficient support in the

[295] *EC—Hormones* (Panel), paras. 6.5–6.7.
[296] *EC—Hormones* (Appellate Body), para. 148.
[297] *Australia—Salmon* (Panel), para. 6.1 *et seq.*
[298] *Japan—Agricultural Products II* (Panel), para. 6.2 *et seq.*
[299] *EC—Hormones* (Panel), para. 6.7.

> evidence. The experts may also be consulted on the relationship between the risk assessment and the SPS measure in order to assist the panel in determining whether the risk assessment "sufficiently warrants" the SPS measure. *The consultations with the experts, however, should not seek to test whether the experts would have done a risk assessment in the same way and would have reached the same conclusions as the risk assessor. In other words, the assistance of the experts is constrained by the kind of review that the panel is required to undertake.* (Emphasis added.)[300]

In practice, that has not always been the case, and the Appellate Body has had to address the issue.[301]

4.9.3 Standard of review

The Appellate Body, starting with *EC—Hormones*,[302] has held the view that WTO adjudicating bodies, when dealing with cases covered by the SPS, have to apply the standard of review defined in DSU Article 11 and do not have to follow any other particular standard of review.

> 585 The Appellate Body has observed that, so far as fact-finding by panels is concerned, the applicable standard is "neither *de novo* review as such, nor 'total deference', but rather the 'objective assessment of facts'". It further explained that, while panels are "poorly suited to engage in [a *de novo*] review", "'total deference to the findings of the national authorities'... 'could not ensure an "objective assessment" as foreseen by Article 11 of the DSU'."
>
> 590 A panel reviewing the consistency of an SPS measure with Article 5.1 must determine whether that SPS measure is "based on" a risk assessment. It is the WTO Member's task to perform the risk assessment. The panel's task is to review that risk assessment. Where a panel goes beyond this limited mandate and acts as a risk assessor, it would be substituting its own scientific judgement for that of the risk assessor and making a *de novo* review and, consequently, would exceed its functions under Article 11 of the DSU. Therefore, the review power of a panel is not to determine whether the risk assessment undertaken by a WTO Member is correct, but rather to determine whether that risk assessment is supported by coherent reasoning and respectable scientific evidence and is, in this sense, objectively justifiable.
>
> 591 The Appellate Body has observed that a WTO Member may properly base an SPS measure on divergent or minority views, as long as these views are from qualified and respected sources. This must be taken into account in defining a panel's standard of review. Accordingly, a panel reviewing the consistency of an SPS measure with Article 5.1 of the *SPS Agreement* must, first, identify the scientific basis upon which the SPS measure was adopted. This scientific basis need not reflect the majority view within the scientific community but may reflect divergent or minority views. Having identified the scientific basis underlying the SPS measure, the panel must then verify that

[300] *US/Canada—Continued Suspension* (Appellate Body), para. 592.

[301] Ibid. para. 436.

[302] *EC—Hormones* (Appellate Body), paras. 110–19; *US/Canada—Continued Suspension* (Appellate Body), paras. 585–616.

the scientific basis comes from a respected and qualified source. Although the scientific basis need not represent the majority view within the scientific community, it must nevertheless have the necessary scientific and methodological rigour to be considered reputable science. In other words, while the correctness of the views need not have been accepted by the broader scientific community, the views must be considered to be legitimate science according to the standards of the relevant scientific community. A panel should also assess whether the reasoning articulated on the basis of the scientific evidence is objective and coherent. In other words, a panel should review whether the particular conclusions drawn by the Member assessing the risk find sufficient support in the scientific evidence relied upon. Finally, the panel must determine whether the results of the risk assessment "sufficiently warrant" the SPS measure at issue. Here, again, the scientific basis cited as warranting the SPS measure need not reflect the majority view of the scientific community provided that it comes from a qualified and respected source.

598 . . . Given the applicable standard of review and the role of the Panel that is determined by it, the Panel's analysis should have proceeded differently. The Panel should have first looked at the European Communities' risk assessment. It should then have determined whether the scientific basis relied upon in that risk assessment came from a respected and qualified source. The Panel should have sought assistance from the scientific experts in confirming that it had properly identified the scientific basis underlying the European Communities' risk assessment or to determine whether that scientific basis originated in a respected and qualified source. The Panel should also have sought the experts' assistance in determining whether the reasoning articulated by the European Communities on the basis of the scientific evidence is objective and coherent, so that the conclusions reached in the risk assessment sufficiently warrant the SPS measure. Instead, the Panel seems to have conducted a survey of the advice presented by the scientific experts and based its decisions on whether the majority of the experts, or the opinion that was most thoroughly reasoned or specific to the question at issue, agreed with the conclusion drawn in the European Communities' risk assessment. This approach is not consistent with the applicable standard of review under the *SPS Agreement*.[303]

5. Conclusions

When the Uruguay Round came to a close, more people than ever before enjoyed a standard of living beyond mere subsistence; it should be noted that this was due in no small part to the trade liberalizing effect of the GATT/WTO legal order. As a consequence, state authorities were increasingly expected to set up regulatory environments in which undesirable consequences emanating from a product or just associated with it (for instance, a rash on children's skin; high sugar content; high fat content), were to be avoided or communicated to the consumers, so as to allow *them* to take these circumstances into account. Clearly, this development contributed to more safety and health standards, mandatory and voluntary labelling, state-imposed or promoted

[303] *US/Canada—Continued Suspension* (Appellate Body), paras. 589–91, 598, footnotes omitted.

by the private sector. In parallel to this development, the very same trade liberalization, referred to above, also reduced the possibilities for governments to use the classic protectionist tools. As a consequence, requests of domestic industries to help protect them against better priced or better built imported goods could only be met with non-tariff measures that created a 'border behind the border': namely, technical barriers, regardless of whether they fall into the sub-set of SPS measures or are 'standard' regulations and standards.

Through the SPS and TBT Agreements, the drafters of the Marrakesh Agreement wanted to tackle these issues and agreed on what they perceived as a compromise between preserving regulatory space for members and the establishment of regulations on unreasonable trade impediments.[304] Two tools were identified as making the system more fair, more rational, and less trade-restrictive: science[305] and internationally established standards—typically by an expert institution not controlled by the parties to a dispute. With hindsight, the jurisprudence of the Appellate Body and the prolific state practice, mostly within the framework of the TBT Committee and the SPS Committee, permits an overall positive evaluation of what has been achieved by these two Agreements and of the framework they establish.

However, a number of issues have not yet been resolved. Possibly, the most prominent one is the negotiators' belief, as manifested in the SPS, that '*scientia vincit omnia*' has been perhaps a tad too simplistic. In any case, it was clearly not acceptable to a number of members in practice. The consequences are felt at every level of the treaty implementation: the role of experts, and by implication that of the economic interests behind them, has proven to be complex and not always satisfactorily addressed. In no case so far has the Appellate Body found the risk assessment underlying the public measure sufficient. While this may make for 'good law' that sends a signal to states to be as careful as possible with trade restrictive technical barriers to trade, it appears that the rejection of policy measures which do not seem per se unreasonable—and which benefit from sometimes overwhelming democratic legitimacy—put a significant systemic strain on the SPS and TBT regimes. The *EC—Hormones* and the *EC—Approval and Marketing of Biotech Products* cases (to name but two examples) will be succeeded probably sooner rather than later by cases on nanotechnology and other new technologies. Again, different members' appetite for risk will vary significantly, as does the preparedness of societies to embrace new technologies: they invariably entail not yet known risks—the famous 'unknown unknowns', but also known, but not fully understood risks—the 'known unknowns'. It would seem that with regard to such new and not yet scientifically fully mapped risks, science is less helpful than the drafters of the two Agreements in this chapter assumed.

[304] According to the Appellate Body the TBT Agreement represents a compromise 'between, on the one hand, the desire to avoid creating unnecessary obstacles to international trade and, on the other hand, the recognition of Members' right to regulate' (*US—Clove Cigarettes* (Appellate Body), para. 96), and the SPS Agreement, a 'delicate and carefully negotiated balance . . . between the shared, but sometimes competing, interests of promoting international trade and of protecting the life and health of human beings' (*EC—Hormones* (Appellate Body), para. 177).

[305] According to *Australia—Apples* (Appellate Body), para. 215, the SPS establishes 'the overarching requirement . . . that there be a "rational or objective relationship" between the SPS measures and the scientific evidence'.

Both Agreements also put a premium on internationally agreed upon standards. The more closely a member conforms with an international standard, the more it is shielded from an examination of the soundness of the evaluations underlying the measure in dispute. This, clearly, raises the question of legitimacy of the standard setting process: possibly unavoidably, the interest of the important actors, who are well represented in the different international bodies charged with elaborating those international templates, are better taken into account than sometimes diffuse public interest.

Lastly, with regard to the TBT Agreement, several Appellate Body reports have had the tendency to apply that Agreement quite broadly, even when the measure at stake was hardly recognizable as a 'technical regulation'. We will have to wait and see whether the recent *EC—Seal Products* report is a welcome departure from that practice or just a fact-specific application.[306]

All of these issues have not yet been fully addressed in WTO law. The Appellate Body can smooth out certain wrinkles—not that it *always* takes up those possibilities—but it cannot play a role similar to the ECJ within the regional international organization that is today the 'European Union': for this, the legal, but, more importantly, the political fundament is utterly missing. Thus, it will take another Round to address these issues. Unfortunately, confidence in the ability of the members to address questions that are universally recognized as meriting the attention of the 'Lords of the Treaty', let alone issues where the need to act is less uniformly recognized, has not increased in recent years. In the absence of 'legislative' action, it will be up to the Appellate Body to slightly loosen the reins of its jurisprudence and keep the promise it made in the 'principled' part of its *EC—Hormones* report.

[306] With regard to other criticism of the Appellate Body's jurisprudence see Petros Mavroidis, 'Driftin' Too Far from Shore—Why the Test for Compliance with the TBT Agreement Developed by the WTO Appellate Body is Wrong and What the AB Should Have Done Instead (2013) *World Trade Report,* Vol. 12, 509–31.

14

Preferential Trade Agreements

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1. Disciplining Preferential Trade Agreements

WTO members, that have satisfied the requirements included in GATT Article XXIV, can justifiably treat products originating in some WTO members (those with which they have formed a preferential trade agreement (PTA))[1] better than like products originating in the remaining WTO members. To this effect, they can, for example, impose a lower than the most favoured nation (MFN) customs duty on imports of widgets when they originate in a PTA partner. GATT Article XXIV is thus an exception to GATT Article I.

GATT Article XXIV GATT distinguishes between two forms of PTAs: free trade areas (FTAs) and customs unions (CUs). For an FTA to be GATT-consistent, its members must liberalize trade between themselves whereas, for a CU to be GATT-consistent, its members must also agree on a common trade policy vis-à-vis the rest of the WTO membership. There is thus a notable difference between the two forms of integration, in the sense that CU implies substantial loss of sovereignty through the emergence of a common external tariff.

[1] Throughout this chapter we prefer the use of the term 'PTA' over the term 'regional integration': the former captures the essence of these schemes, since participants in such arrangements will be treated better than outsiders; the latter term reflects a historical feature. Not all such schemes are regional in the sense of geographic proximity anymore. One third of FTAs currently under investigation are among countries that are not in geographic proximity: the number of cross-regional schemes has risen from six in 1995 to eighty in 2008. The FTAs between the EU and Mexico, Australia and Chile, and Mexico and Japan underscore this point. Moreover, as André Sapir notes in André Sapir, 'European Integration at the Crossroads: A Review Essay on the 50th Anniversary of Bela Belassa's Theory of Economic Integration' (2011) *Journal of Economic Literature* 49, 1200–29, the origin of the term 'regional integration' is uncertain as the term does not appear in the body of GATT Art. XXIV. He notes that this term was first used in an official GATT document in February 1996 when the WTO established the Committee on Regional Trade Agreements to examine the consistency of FTAs and customs unions (CUs) with the WTO. Dam (1963) is credited by Sapir as the first author to use the term 'regional trade agreements' probably because in the early sixties all preferential schemes were across regional partners.

FTAs and CUs do not, of course, exhaust the forms of market integration, as indeed the EU experience shows. Balassa[2] provided a classification of 'stages of integration' whereby FTA and CU were the two 'shallowest' forms of market integration; next would come the common market, where factors of production (and not only trade restrictions) would be eliminated; then, the economic union, where some form of harmonization of economic policies would occur, and finally a complete economic integration which would entail unification of monetary, fiscal, and social policies and where a central authority entrusted with the capacity to issue binding rules would be established.

Balassa did see some sequence across the various stages.[3] Sapir[4] does not. In his view, there is no reason to believe that there is some form of automaticity in the integration process that leads from FTAs to CUs. Indeed, the numbers here tell a story since there are only a handful of CUs that have been notified to the WTO and for some of these there are legitimate doubts as to whether they have established a genuine common external tariff.[5] He bases his conclusion in part on the unwillingness of states to yield sovereignty to supranational institutions, and this is why there are so many FTAs, and so few CUs.

2. The Negotiating History of GATT Article XXIV

The negotiating history of GATT Article XXIV does not reveal a dominant explanation for its inclusion. What is clear is that the view held by many that the inclusion of a provision was meant to accommodate the European integration process is wrong. In Dean Acheson's record,[6] Jean Monnet revealed his plans on European integration after the Havana Conference had taken place.

Arguably, one reason for its inclusion is that the GATT negotiators were presented with a fait accompli: two CUs participated in the negotiation, the Syro–Lebanese customs union (Syria and Lebanon) and Benelux (Belgium, the Netherlands, and Luxembourg). Institutional arrangements had to be made anyway in order to accommodate these contracting parties.

Chase,[7] drawing from a series of archival records explains the extension of the original provision (which was limited to CUs) to cover FTAs as well: the author

[2] Bela Balassa, 'Trade Creation and Trade Diversion in the European Common Market' (1967) *Economic Journal* 77, 1–21.

[3] He was not alone: Jacob Viner, *The Customs Union Issue*, *Carnegie Endowment for International Peace* (New York, 1950) 3ff. took the view that a sequence across the various forms of market integration corresponded to sound intellectual criteria; in his view, political unions should come before customs unions and that the German Zollverein where the customs union preceded the political union was quite idiosyncratic.

[4] André Sapir, 'European Integration at the Crossroads: A Review Essay on the 50th Anniversary of Bela Balassa's Theory of Economic Integration' (2011) *Journal of Economic Literature* 49, 1200–29.

[5] At the time of writing (December 2011) the WTO has been notified of only the following CUs: the Caribbean Community and Common Market (CARICOM); the Central American Common Market (CACM); the Eurasian Economic Community (EAEC); the European Union (EU); the EU CUs with Andorra, San Marino, and Turkey; the South African Customs Union (SACU).

[6] Dean Acheson, *Present at the Creation: My Years in the State Department* (New York: W. W. Norton, 1969).

[7] Kerry Chase, 'Multilateralism Compromised: The Mysterious Origins of GATT Article XXIV' (2006) *World Trade Review* 5, 1–30.

demonstrates that it was the US negotiators who designed this provision in order to accommodate a trade agreement that they had secretly reached with Canada: references to FTAs were thus included in Article 44 of the Havana Charter (the corresponding provision to GATT Article XXIV) and appear for the first time only in 1948.[8] The US–Canada FTA, alas, was never ratified.

3. A View from the World of Economics

Economists and political scientists have advanced various explanations as to why one might opt to go preferential.[9] If there is one characteristic that is common to all such explanations it is that they are all idiosyncratic.

3.1 The cost side

PTAs come at a cost. Viner was the first to explain why PTAs are welfare-reducing in light of the resulting trade diversion (deflection).[10] When A and B form a PTA they create trade, since they dismantle pre-existing protection between them. They also divert trade though, since intra-PTA trade might displace extra-PTA trade (trade deflection). It could be the case that the most efficient sources of a particular commodity is C, and that by privileging trade from B, A will be diverting trade from the absolutely most efficient source (C) to the relatively (that is, intra-PTA) more efficient source (say B). Trade diversion is costly, and this is what Viner's work alerted us to.

There is cost of course not only for the consumers located inside the PTA (who now pay a higher price) but also for traders outside the PTA who now have to look for new markets.[11]

Influenced by Viner's analysis, economists initially viewed regional integration with a great deal of scepticism.[12] Scholarship backed up this scepticism. Influential papers

[8] Compare Viner, *The Customs Union Issue* (1950), n. 3 at 113ff.

[9] Maurice Schiff and L. Alan Winters, *Regional Integration and Development* (Oxford: Oxford University Press, 2003).

[10] It is not the case that trade diversion is a necessary evil stemming from the creation of PTAs: the Kemp-Wan theorem posits that trade diversion can be eliminated by reducing external tariffs so as to keep trade with non-members unchanged, keeping, in other words, prices constant. The result in the Kemp-Wan theorem applies in a set of given circumstances. The Kemp-Wan theorem, nonetheless, is not a *passage obligé* in order to support a claim that PTAs can be welfare-improving.

[11] And there is a lot of empirical evidence in this context: Sapir 'Domino Effects in Western European Regional Trade, 1960–1992' (2001) *European Journal of Political Economy* 17, 377–88, for example, examines trade deflection as a result of the deepening of the EU integration process following the single market project. He finds substantial negative welfare implications for EFTA (European Free Trade Association) exporters to the EU which he attributes to the 'quality' of market integration at the EU-level. Similar data lend support to Richard Baldwin, 'A Domino Theory of Regionalism' in Richard E. Baldwin, Pertti Haaparanta, and Jiakko Kiander, eds., *Expanding Membership of the European Union* (New York City: Cambridge University Press, 1995) 25–48, who argues that the EU integration had a domino effect and led EFTA members to knock on the door at Brussels and request full accession to the EU.

[12] Richard, E. Baldwin and Anthony J. Venables, 'Regional Economic Integration' in Gene M. Grossman and Kenneth Rogoff, eds., *Handbook of International Economics*, vol. 3 (Amsterdam, New York, and Oxford: Elsevier-North Holland, 1995) 1597–644; Arvind Panagariya, 'Preferential Trade Liberalization: The Traditional Theory and New Developments' (2000) *Journal of Economic Literature* 38, 287–331; L. Alan Winters 'Preferential Trading Agreements: Friend or Foe?' in Kyle W. Bagwell and Petros

from the likes of Grossman and Helpman[13] and Krishna[14] established the incentive for PTA partners to choose integration in these sectors where the possibility for preference (and thus, trade deflection) is greatest. True, the GATT legal test does provide some insurance against this possibility (through the requirement to liberalize 'substantially all trade' (SAT), as we will see later), but the legal test was almost never respected in the first place.

The natural consequence of this analysis is that PTA partners have missing incentives to agree, following establishment of a PTA, on most favoured nation (MFN) tariff cuts for fear of preference erosion. Limão[15] has contributed theoretical and empirical papers in this vein. Besides trade diversion generated through the establishment of PTAs, members of PTAs behave as enemies of non-discriminatory trade liberalization in the future as well, since they are unwilling to cut tariffs on an MFN basis for fear of eroding the margin of preference that they have already granted to their PTA partners. They become thus, as Bhagwati and Panagariya[16] put it, stumbling blocks (as opposed to building blocks) in the multilateral trading system, opposing MFN trade liberalization, and frustrating the achievement of the basic WTO objective. In other words, trade diversion is here to stay as a result of the incentives of PTA partners.[17] Bhagwati[18] goes so far as to state that:

> It is hard to contemplate the consequences of PTAs with equanimity. The most important item in our policy agenda has to be to devise an appropriate response to their spread and the damage they impose on the multilateral trading system.

As is the case with costs where we distinguish between static (trade deflection) and dynamic costs (refusal to make MFN cuts for fear of preference erosion), we can distinguish between static and dynamic gains. Baldwin[19] correctly suggests that it is an onerous exercise to estimate the dynamic effects of preferential agreements; some of them, for example, might be shielded within the realm of private information that is never revealed to the rest of the world (for example, side payments in the form of

C. Mavroidis, eds., *Preferential Trade Agreements: A Law and Economics Analysis* (New York: Cambridge University Press, 2011) 7–30 have contributed an excellent survey on the economics of PTAs.

[13] Gene Grossman and Elhanan Helpman, 'The Politics of Free Trade Agreements' (1995) *American Economic Review* 85, 667–90.

[14] Pravin Krishna, 'Regionalism and Multilateralism: A Political Economy Approach' (1998) *Quarterly Journal of Economics* 113, 227–51.

[15] Nuno Limão, 'Preferential Trade Agreements as Stumbling Blocks for Multilateral Trade Liberalization: Evidence for the U.S.' (2006) *American Economic Review* 96, 896–914.

[16] Jagdish Bhagwati and Arvid Panagariya, 'Preferential Trading Areas and Multilateralism—Strangers, Friends, or Foes' in Jagdish Bhagwati, Pravin Krishna, and Arvind Panagariya, *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements* (Cambridge, M.A., MIT Press, 1999) 33–100.

[17] Note that theory is not unanimous in this respect. Saggi and co-authors design models with endogenous cuts in order to ascertain whether MFN cuts are a counterfactual to preferential cuts: Kamal Saggi and Halis Murat Yildiz, 'Bilateralism, Multilateralism, and the Quest for Global Free Trade' (2011) *Journal of International Economics* 81, 26–37.

[18] Jagdish Bhagwati. *Termites in the World Trading System* (New York: Oxford University Press, 2008).

[19] Baldwin and Venables, 'Regional Economic Integration', n. 12.

support for a permanent or temporary seat with the UN Security Council). Baldwin notes that the difficulty of calculating similar benefits is no intellectual reason to outright exclude them from any calculation.

Against this background why do rational agents go preferential?

3.2 The benefit side

The rationale for 'going preferential' is endogenous in the agreement about to be formed.

The EU for example, has been an early champion of preferential trade, recently copied by various eager beavers. Trade policy was for years the only genuine EU common policy and one cannot resist the temptation to ask the question whether PTAs were not part of a wider 'I sign, *ergo* I exist' strategy. With every PTA signed, the EU was affirming its international persona becoming thus more of a figure in international relations.[20]

There are other, more generally applicable explanations for going preferential. To start with, PTAs are close to 'natural' integration schemes across geographically proximate partners. Tinbergen[21] was first to explain that the formation of PTAs was in some ways quite natural. He developed the 'gravity equation', aimed to predict trade in the absence of distortions: trade is an increasing function of the gross national product (GNP) of both the exporting, and the importing country; trade is further negatively influenced by the distance between the countries. Gravity models have been successfully used to explain the formation of PTAs especially between partners in geographic proximity to each other.[22]

Krugman[23] and Summers[24] have gone one step further and have argued that PTAs among countries in geographic proximity should be encouraged, whereas PTAs among countries which are not neighbours (in a geographic sense) should be discouraged. In their analysis, the former are more likely to avoid the adverse possibility of welfare reduction and to lead to a bigger improvement in welfare.[25]

[20] This is not to say that this is the only reason why the EU signed PTAs: for a start, PTAs have been used as ante-chambre for EU accession. Marise Cremona, 'The European Union and Regional Trade Agreements' in Christoph Hermann and Philipp Terhechte, eds., *The European Yearbook of International Economic Law* (Berlin and London: Springer Verlag, 2010) 245–68, and Walter Mattli, *The Logic of Regional Integration: Europe and Beyond* (Cambridge: Cambridge University Press, 1999) provide very comprehensive and analytical accounts of European regionalism in its historical dimension.

[21] Jan Tinbergen, *Shaping the World Economy, The Twentieth Century Fund* (New York City, 1962).

[22] The term 'distance' refers not only to geographical distance (for example, transportation costs), but also to other associated obstacles, such as the cost of information on the export market due to, for example, language differences, historical and cultural factors, etc. The term 'gravity' was chosen in reference to Newton's law describing the force of gravity as a function of the product of the masses of the two objects, and the distance between them.

[23] Paul Krugman, 'The Move Toward Free Trade Zones' (1991) *Economic Review* 35, 1–24.

[24] Larry Summers, 'Regionalism and the World Trading System' in *Policy Implications of Trade and Currency Zones* (The Federal Reserve Bank of Kansas City, 1991) 42–65.

[25] It is questionable how strong this claim is since there is empirical evidence that there are substantial border effects. James E. Anderson and Eric van Wincoop, 'Gravity with Gravitas: A Solution to the Border Puzzle' (2003) *American Economic Review* 93(1), 170–92, for example, have estimated that national borders reduce trade between industrialized countries by moderate amounts of 20 and 50 per cent.

Krugman[26] observes that a trading block could be formed in order to improve the terms of trade for its participants. In this view, a similar arrangement

> will normally have more monopoly power in world trade than any of its members alone. The standard theory of the optimal tariff tells us that the optimal tariff for a country acting unilaterally to improve its terms of trade is higher, the lower the elasticity of world demand for its exports. So for a trading bloc attempting to maximize the welfare of its residents, the optimal tariff rate will normally be higher than the optimal tariff rates of its constituent countries acting individually.[27]

Kowalczyk[28] has shown, employing terms of trade and volume of trade analysis, trade creation and diversion do not necessarily equate with welfare gains and losses. WTO members might be deriving important political benefits by association with their preferential partners, and this is most likely the case when associating themselves with the two main hubs, the EU and the United States. This observation might also explain why those originally left out might wish to join in subsequently.[29]

NAFTA was beneficial to Mexico not simply because the United States lowered its tariff barriers to Mexican goods and services, but also because Mexico benefited from other dynamic benefits, such as, increased investment over the years as a result of rationalization of its policies, etc.[30]

In a similar vein, Baltagi et al.[31] discuss the relationship between PTAs and FDI (foreign direct investment) and conclude in an empirical paper regarding the Europe Agreements that removal of trade barriers has led to substantial flows of FDI for those participating: recourse to PTAs could thus be privileged because a country sees a PTA as a way to get investment/access to foreign technology that can increase its income, or access to low-cost production of inputs that can increase its ability to export certain products; or even that trade is a component of a wider public policy package.[32]

Dynamic (indirect) benefits can be of different nature as well. It could also be, for example, that PTAs serve as 'signalling mechanisms'. Mexico, by joining NAFTA, not only enjoyed trade and investment benefits, but also signalled to the world that it was abandoning its policies of the past and was espousing a different model. Association

[26] Krugman, 'The Move Toward Free Trade Zones', n. 23 at 10.

[27] L. Alan Winters and Won Chang, 'Regional Integration and Import Prices: An Empirical Investigation' (2000) *Journal of International Economics* 51, 363–77, for example, find that non-EU countries experienced terms of trade losses when Spain and Portugal joined the EU in 1986.

[28] Carsten Kowalczyk, 'Welfare and Customs Union' (1990) NBER Working Paper No. 3476.

[29] To the point that one might come close to accurate predictions as to who will join, see Richard, E. Baldwin 'The Causes of Regionalism (1997) *The World Economy* 20, 865–88, and Baldwin and Venables, 'Regional Economic Integration', n. 12.

[30] Lorenzo Caliendo and Fernando Parro, *Estimates of the Trade and Welfare Effects of NAFTA* (University of Chicago, Chicago, Ill.: Mimeo, 2009).

[31] Badi H. Baltagi, Peter Egger, and Michael Pfaffermayr, 'Estimating Regional Trade Agreement Effects on FDI in an Interdependent World' (2008) *Journal of Econometrics* 145, 194–208.

[32] One might legitimately ask the question whether a PTA is the necessary vehicle for these kinds of perks. As things stand, we know that PTAs have proved to be the vehicle by comparing the *ex ante* to the *ex post* situation, without asking the additional question whether similar perks would have been obtained in a non PTA-scenario (a difficult, if not impossible, counterfactual).

with this particular hub (United States) was a strong signal to this effect. This in turn, may have eased the relationship of Mexico with international organizations, financial markets, etc.

Becoming a preferential partner in trade might thus open the door to all sorts of political cooperation. Obtaining political perks, which might be indirect and uncertain, could on occasion be the key motivation as to why spokes decide to go preferential with hubs. PTAs are part and parcel of a wider foreign policy and might be motivated only, or mainly, by concerns of political order: China, for example, has not signed any PTA with WTO members that have recognized Chinese Taipei.

In short, it is as impossible to respond in a horizontal manner to the question as to why PTAs are formed, as it is to decide on their (positive or negative) welfare implications.

4. The Test for Compliance

The legal and the economics tests for giving the green light to a PTA are like two ships passing in the night. Irrespective of their differences, what stems from the discussion above is that economists care about the welfare implications of PTAs. This is the question that the legal test embedded in GATT Article XXIV does not ask. This provision aims at avoiding PTAs *à la carte* and ensuring that intra-PTA trade liberalization is not be accompanied by additional protection vis-à-vis the rest of the world. The result could be very substantial trade diversion (especially for early PTAs in the 1950s and the 1960s when MFN tariffs were quite high).[33] This was not a concern for the GATT drafter. The underlying hypothesis must have been that GATT should be prepared to incur a (temporary) cost to accommodate those who wanted to go further, faster. Eventually, the world would catch up by liberalizing on MFN-basis, albeit at a slower pace. Obviously, the GATT drafters paid no attention to the 'stumbling blocks' argument.

Before we move to a detailed discussion of the relevant legal provisions though, note that GATT Article XXIV.4 leaves no doubt that there is room for PTAs under the aegis of the multilateral framework:

> The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

The wording and the negotiating history should leave no doubt that GATT Article XXIV was intended as an exception to GATT Article I.[34] With the advent of the WTO, the question arises whether it is an exception to other provisions as well. The Appellate

[33] As noted by Grossman and Helpman though, 'The Politics of Free Trade Agreements', n. 13, the result is also that good faith WTO members will not integrate only those sectors where the maximum trade deflection is possible.

[34] David A. Gantz, 'Regional Trade Agreements' in Daniel Bethlehem, Donald McRae, Rodney Neufeld, and Isabelle Van Damme, eds., *The Oxford Handbook of International Trade Law* (Oxford: Oxford University Press, 2009) 237–68 offers a comprehensive account in this respect.

Body, in its report on *Turkey—Textiles*, responded in the affirmative and held that recourse to this provision could justify deviations from Article 2.4 of the Agreement on Textiles and Clothing (ATC):

> Article XXIV may justify a measure which is inconsistent with certain other GATT provisions.

The Appellate Body explained in the same report the conditions under which this exception may be successfully invoked, and stated in unambiguous terms that the party invoking GATT Article XXIV to justify deviations from MFN trade carries the associated burden of proof (§58):

> First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of a customs union that fully meets the requirements of sub-paragraphs 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue.

Still, this provision can only serve as an exception to measures aiming to protect domestic producers. Measures not aiming to protect domestic producers, like those covered by GATT Article III, cannot come under the purview of GATT Article XXIV at all.

The Panel on *Canada—Autos* added that, for a WTO member to successfully invoke this provision it must show that the measure it wishes to justify is granted to all PTA partners and it is not granted to non-PTA partners. Unless this is the case, an otherwise GATT-inconsistent measure cannot find shelter in GATT Article XXIV (§§10.55 to 10.56).

4.1 Notification

WTO members deciding to enter into a PTA have to notify the WTO of their intention to do so (GATT Article XXIV.7).[35] Notifications will be submitted to the Committee on Regional Trade Agreements (CRTA), where the compatibility of the notified scheme with the multilateral rules will be reviewed.[36] The CRTA[37] is the successor to GATT Article XXIV Working Parties, the organ that used to examine the consistency of notified PTAs with the multilateral rules. There is not much substantive difference between the two bodies other than the fact that the CRTA is the consolidation of prior

[35] WTO members must notify the WTO of a CU, an FTA, or an interim agreement leading to a FTA or a CU. In this latter case there is a requirement to report the implementation of the PTA within set periods, WTO Doc. TN/RL/W/8/Rev. 1 of 1 August 2002.

[36] There have not been many complaints regarding lack of notification of PTAs. Still, the issue has been raised and a proposal has been tabled to eventually introduce the possibility for cross-notification of PTAs that have not been previously notified, WTO Doc. TN/RL/W/8/Rev. 1 of 1 August 2002. There is a standard notification format for PTAs irrespective under which provision (GATT, GATS, Enabling Clause) they are notified, WTO Doc. G/L/834 of 8 November 2007.

[37] For a more detailed discussion on the inception of the CRTA, see Petros C. Mavroidis, 'If I Don't Do it, Somebody Else Will (or Won't)' (2006) *Journal of World Trade* 40, 187–214.

practice into a 'permanent' organ: participation in Working Parties was open to all GATT contracting parties, and this is the case with respect to the CRTA as well.

The CRTA was established through a decision by the WTO General Council on 7 February 1996 which in part requests from the CRTA:[38]

> (a) to carry out the examination of agreements in accordance with the procedures and terms of reference adopted . . . and thereafter present its report to the relevant body for appropriate action;
>
> . . .
>
> (b) to consider the systemic implications of such agreements and regional initiatives for the multilateral trading system.

The CRTA adopts its decisions by consensus as per Rule 33 of the Rules of Procedure for Meetings of the Committee on Regional Trade Agreements:[39]

> Where a decision cannot be arrived at by consensus, the matter at issue shall be referred, as appropriate, to the General Council, the Council for Trade in Goods, the Council for Trade in Services or the Committee on Trade and Development.

There is no reported case of referral to a higher body. In principle, the CRTA has wide powers. GATT Article XXIV.7 provides in this context that the organs examining the consistency of notified PTAs have the power:

> . . . to make such reports and recommendations to contracting parties as they may deem appropriate.

In principle, one cannot exclude the possibility that the CRTA will conclude that a notified PTA is WTO-inconsistent. The possibility of such a conclusion is underscored by the explicit wording of GATT Article XXIV.7(b), which explains the powers of the CRTA when it reviews an interim agreement leading to the establishment of a CU or an FTA:

> If . . . the CONTRACTING PARTIES find that such agreement is not likely to result in the formation of a customs union or of a free-trade area . . . the CONTRACTING PARTIES shall make recommendations to the parties to the agreement. *The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations* [emphasis added].

Never in the history of the GATT have GATT contracting parties reached a decision that a notified scheme was inconsistent with the multilateral rules. For years, the final report of an Article XXIV Working Party would look like an expression of disagreement regarding the consistency of various aspects of the notified PTA with the multilateral rules between those being reviewed (and their allies), and those reviewing. The situation has not changed in the WTO era either, as we will see in what follows. The CRTA will circulate two documents: a factual abstract (an executive summary of the discussions held in the CRTA), and a factual presentation (the final report, which will provide factual information on various aspects of the notified PTA).

[38] WTO Doc. WT/L/127. [39] WTO Doc. WT/REG/1 of 14 August 1996.

Recall that it is the Committee on Trade and Development (CTD) that should be notified of arrangements across developing countries (south–south cooperation). We are consequently left with the following possible scenarios for PTAs notified under GATT Article XXIV:

(a) between developed countries all of which are WTO members;
(b) between WTO members some of which qualify as developed and some as developing countries;
(c) between a WTO member which qualifies as a developed country and a non-WTO member.

There should be no doubt that the CRTA should be notified of PTAs coming under the first two categories. The last category raises some legitimate issues. One would think that GATT Article XXIV requires to be observed by WTO members only. Article XXIV.5 reads:

> Accordingly, the provisions of this Agreement shall not prevent, *as between the territories of contracting parties*, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; [emphasis added].

In this vein, to the extent a WTO member grants an advantage to a non-WTO member by signing a PTA to this effect, it would, by virtue of GATT Article I, have to extend it automatically and unconditionally to all WTO members. Yet, practice has developed in a different way. WTO members, irrespective of whether they are developed or developing, notify the CRTA and/or the CTD of their PTAs with non-WTO members as well: EC–Cariforum (Bahamas is part of the Agreement, but not a WTO member) is an example of the former, and Ukraine–Uzbekistan of the latter.[40] Practice has arguably developed *contra legem* in this respect since WTO members now, when signing PTAs with non-WTO members do not have to extend benefits automatically and unconditionally to all other WTO members.

Practice also evidences dual notifications simultaneously to the CRTA and the CTD. When MERCOSUR was established, it was notified under the Enabling Clause only, since all participants were developing countries. It was later agreed that the terms of reference of the Working Party should, in this particular case, also include an examination of the consistency of MERCOSUR with GATT Article XXIV:

> To examine the Southern Common Market Agreement (MERCOSUR) in the light of the relevant provisions of the Enabling Clause and of the GATT 1994, including Article XXIV, and to transmit a report and recommendations to the Committee on Trade and Development for submission to the General Council, with a copy of the report transmitted as well to the Council for Trade in Goods. The examination in the Working Party will be based on a complete notification and on written questions and answers.

[40] The WTO was also notified of the FTAs between Turkey and Syria, and EFTA and Lebanon, although neither Syria nor Lebanon are WTO members.

Eventually, MERCOSUR was discussed before the CRTA. Both the CTD and the CRTA were also notified of the CU established by the members of the GCC (Gulf Cooperation Council), and the India–Korea and Korea–ASEAN FTAs. A number of developing countries raised concerns regarding the legality of this practice: in a joint communication, China, Egypt, and India pointed to the absence of a legislative framework enabling dual notifications and the ensuing uncertainty regarding both the impact of the various provisions as well as the role of the CTD and the CRTA that should be acknowledged in this process.[41] At the time of writing this is still an open issue. A General Council decision did not manage to clarify this issue:

> Notifying Members shall specify under which provision or provisions in paragraph 1 their PTAs are notified.[42]

The use of the plural ('provisions') could be taken as indication that dual notifications are now possible, although it could also be taken as indication that it refers to notifications under GATT Article XXIV and GATS Article V only.

GATT Article XXIV:7(a) addresses the timing of notification:

> Any contracting party *deciding to enter* into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall *promptly* notify the CONTRACTING PARTIES and shall make available . . . such information . . . as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate [emphasis added].

The language of GATT Article XXIV suggests the CRTA should be notified of a prospective action; according to the Transparency Mechanism (that we discuss below), all PTAs should be notified as early as possible and, in any case, immediately following their ratification by participants. The WTO Secretariat (the TPRM Division) will then prepare a factual presentation of the PTA to be circulated to all WTO members.[43] It quite frequently happens, however, that PTAs are notified with substantial delays. For example, NAFTA was signed on 17 December 1992 and entered into force on 1 January 1994, yet a Working Party to examine its consistency with the GATT rules was only established on 23 March 1994. The EC–Visegrad Agreements (an FTA between the EU on one hand, and Hungary, Poland, and the Czech and Slovak Federal Republic on the other) entered into force on 16 December 1991, and the Working Party was only established on 30 April 1992.

Consequently, Working Parties (and now the CRTA), have often been presented with a fait accompli. This is an important observation, especially in light of the de facto absence of retroactive remedies in the GATT/WTO legal system: it would suggest that the CRTA does not have to provide the necessary green light for a PTA to lawfully enter into force. At least one WTO Panel report (*US—Line Pipe*) has taken this view. A General Council decision regarding the content of notifications formally accepted that notifications can take place after the entry into force of the notified PTA:

[41] WTO Doc. WT/COMTD/W/175 of 30 September 2010.
[42] WTO Doc. WT/L/806 of 16 December 2010.
[43] WTO Doc. TN/RL/18 of 13 July 2006.

> The required notification of a PTA shall take place as early as possible; it will occur when practicable before the application of preferential treatment by the notifying Member and, at the latest, three months after the PTA is in force.[44]

The advent of the Transparency Mechanism has provided the official confirmation of past practice in this respect. It was through a General Council decision that the Transparency Mechanism for Regional Trade Agreements was adopted on 14 December 2006.[45] Since the advent of the Transparency Mechanism, WTO members have refrained from discussing the legal consistency of notified PTAs with GATT Article XXIV in the context of review under the CRTA.[46]

The Transparency Mechanism was originally supposed to complement the existing legal arsenal dealing with PTAs (GATT Article XXIV; Understanding on GATT Article XXIV; Decision on the establishment of the CRTA), by clarifying the date of notification of a PTA, imposing the obligation to notify the WTO of any negotiations that might lead to a PTA, and, in general, to detail the kind of information that a notification was required to include.[47]

In practice, however, the Transparency Mechanism has not complemented, but has rather substituted the previous arsenal. The multilateral review has de facto been narrowed down to a mere exercise in transparency.

The multilateral review is consequently definitely not the green light for the advent of PTAs any more; the CRTA is not in this respect akin to a merger authority that has to clear a merger before the latter can be lawfully consummated. With this in mind, we turn to a discussion of the substantive requirements that GATT-consistent PTAs must meet.

The content of notification has been standardized for all PTAs irrespective of whether they are notified under the Enabling Clause or GATT Article XXIV. WTO members have adopted a decision, on a provisional basis (pending its permanent application), regarding the content of notified PTAs.[48] The various Annexes to the decision clarify that information regarding the identity of participants, the products treated preferentially, the volume of preferential trade, etc. must be notified.

4.2 Substantially all trade

This requirement (often referred to in the literature as the 'internal requirement') is common for FTAs and CUs alike. According to GATT Article XXIV.8, WTO members wishing to enter into a CU or an FTA, will have to eliminate duties and other restrictive

[44] WTO Doc. WT/L/806 of 16 December 2010.

[45] WTO Doc. WT/L/671 of 18 December 2006.

[46] For a typical illustration, see the CRTA report on the FTA between Thailand and New Zealand, WTO Doc. WT/REG207/3 of 3 January 2007.

[47] There was dissatisfaction with the amount of information provided by those participating in the notified PTA. There are many reasons explaining why, and dispute settlement awareness figures, according to official WTO documents, are among the most important: the fear that information provided might lead to dispute settlement cases against them. As we go on to discuss, such fears are probably exaggerated.

[48] WTO Doc. WT/L/806 of 16 December 2010.

regulations of commerce (ORRC) with respect to substantially all trade (SAT) in products originating in the constituents of the PTA.

Grossman and Helpman[49] have persuasively argued that the inclusion of this requirement serves a legitimate purpose. Absent this requirement, WTO members will have the incentive to conclude preferential deals on commodities where the largest possible trade diversion could result. It is not thus, only PTAs *à la carte* that will be avoided, but among them those PTAs that might have the most nefarious welfare implications.

The merits for including it notwithstanding, this provision remains even today largely un-interpreted. Its terms were not clarified through subsequent legislative action, not even in the Uruguay Round negotiations, where other terms of this provision were successfully negotiated and clarified.[50]

Inevitably, then, we have to turn to practice, that is, the various Article XXIV Working Parties that have dealt with this issue. But even a cursory overview of practice in this area leaves the researcher with the impression that this is an area where trading partners have found it impossible to agree on a particular meaning.

Here is an inventory of some representative views heard on this issue. It has been suggested that the term 'substantially all trade' has both a quantitative as well as a qualitative component, in the sense that it covers a certain percentage of trade and at the same time no major sector of a national economy can be excluded.[51] The opinion has also been expressed in the *EEC Working Party* that it is:

> inappropriate to fix a general figure of the percentage of trade which would be subjected to internal barriers.[52]

In the same Working Party, various EU Member States expressed the view that:

> a free-trade area should be considered as having been achieved for substantially all trade when the volume of liberalized trade reached 80 per cent of total trade.[53]

The Working Party report on EFTA on the other hand, records the view that:

> the percentage of trade covered, even if it were established to be 90 per cent, was not considered to be the only factor to be taken into account.[54]

Other Working Party reports reflect the view that the exclusion of a whole sector, no matter what percentage of trade is involved, is contrary to the spirit of both GATT Article XXIV, and the GATT itself.[55] Nothing has changed in this respect in more recent years.[56] Discussions in the context of the CRTA are hardly illuminating. The GATT Analytical Index, volume 2 (824, footnote 162) provides an exhaustive list of

[49] Grossmann and Helpman,'The Politics of Free Trade Agreements' (1995), n. 13.

[50] James H. Mathis, *Regional Trade Agreements in the GATT/WTO, Article XXIV and the Internal Trade Requirement* (The Hague: T.M.C. Asser Press, 2002).

[51] GATT Analytical Index, 824–5.

[52] Working Party report on *EEC*, GATT Doc. B.I.S.D. 6S/100, §34.

[53] See GATT Doc. B.I.S.D. 6S/70, §30.

[54] GATT Doc. B.I.S.D. 96/83, §48.

[55] Working Party report on *EEC—Agreements with Finland*, GATT Doc. B.I.S.D. 29S/79, §12.

[56] Working Party report on *Free Trade Area between Canada and the US*, GATT Doc. B.I.S.D. 38S/73, §83.

Working Party reports dealing with this issue; the inescapable conclusion is that trading partners did not manage to clarify this term in subsequent practice. In a series of papers that the WTO Secretariat prepared for the CRTA,[57] this conclusion was re-confirmed: fifty years of practice notwithstanding, WTO members have failed to come up with a workable definition of the term.

Probably the most appropriate way to sum up practice in this field is offered by the Working Party report on *EC—Agreements with Portugal*[58] where the EU delegate noted that:

> there is no exact definition of the expression referring to the term "substantially all trade".

After the conclusion of the Uruguay Round, Australia tabled a proposal to clarify the term 'substantially all trade'.[59] Australia parted company with the oft-mentioned but nebulous idea that the term reflects both a quantitative and a qualitative element. Australia proposed that, to comply with this requirement, WTO members should be requested to liberalize 95 per cent of all the six-digit tariff lines listed in the Harmonized System (HS). In its response to questions by other WTO members,[60] Australia accepted that the 95 per cent figure was an arbitrary benchmark. In its view nonetheless, coming up with a number was an appropriate device intended to move negotiations out of a deadlock and provide a workable and reasonable rule of thumb. Australia was also mindful of the fact that in the case where trade is concentrated in only a few products, the 95 per cent figure could exempt sizeable trade flows. This is why it also proposed an assessment of prospective trade flows under an arrangement at various stages. Australia did not manage to persuade its partners that its proposal was well-founded and it has since died a slow death. This was one of the very few proposals to interpret SAT in a meaningful manner: a document from the WTO Negotiating Group on Rules underscores that very few proposals aiming to clarify its meaning have been tabled.[61]

More recently, a General Council decision implicitly at least suggests that the SAT requirement does not require liberalization of all trade involved.[62] In its Annex 2 it requires that notifying WTO members provide information regarding the list of ineligible products as well as the preferential trade volume affected in the last three years (prior to the notification).

The other term featured in this provision is 'duties and other restrictive regulations of commerce'. GATT Article XXIV.8 does not define this term any further but, in a notorious parenthesis, exempts from its coverage measures coming under the purview of Articles XI, XII, XIII, XIV, XV, and XX. There should be no doubt that the term

[57] WTO Docs. WT/REG/W/17 of 31 October 1997; WT/REG/W/17/Add 1, of 5 November 1997; WT/REG/W/17/Corr. 1, of 15 December 1997); WT/REG/W/17/Rev. 1, of 15 February 1998.

[58] GATT Doc. B.I.S.D. 20S/171, §16.

[59] WTO Doc. WT/REG/W/18, of 17 November 1997.

[60] WTO Doc. WT/REG/W/22/Add. 1 of 24 April 1998.

[61] WTO Doc. JOB/RL/3 of 25 January 2011.

[62] WTO Doc. WT/L/806 of 16 December 2010.

'duties' refers to customs duties, and hence, interpretative issues arise only with respect to the term 'other restrictive regulations of commerce'.

Two issues arise: first, whether the list of measures mentioned in parenthesis and thus exempted is exhaustive or not; second, whether the exempted measures can help the interpreter define the full ambit of the term 'other restrictive regulations of commerce'.

Practice does not address this issue in a dispositive manner. It seems to suggest that inferences from the omission of GATT Article XXI from the list reflected in parenthesis can legitimately be drawn. The issue was discussed in the Working Party on EEC. The view of the (then) EEC Member States was that:

> it would be difficult, however, to dispute the right of contracting parties to avail themselves of that provision which related, inter alia, to traffic in arms, fissionable materials, etc., and it must therefore be concluded that the list was not exhaustive.[63]

Similar voices have been raised in the context of other Working Party reports.[64] The argument in favour of acknowledging the indicative character of the list has been reinforced by discussions regarding the exclusion of GATT Article XIX. During the Uruguay Round negotiations, a draft decision was tabled to clarify this issue:

> When an Article XIX action is taken by a member of a customs union or free-trade area, or by the customs union on behalf of a member, it [need not] [shall not] be applied to other members of the customs union or free-trade area. However, when taking such action it should be demonstrated that the serious injury giving rise to the invocation of Article XIX is caused by imports from non-members; any injury deriving from imports from other members of the customs union or free-trade area shall not be taken into account in justifying the Article XIX action.[65]

Had this proposal been accepted, it would have provided a much needed clarification in this area and would have laid to rest ambiguities surrounding the relationship between GATT Article XIX and Article XXIV. The proposal was, alas, rejected. WTO adjudicating bodies have already faced the question whether a member of a PTA (a CU in the first case,[66] and an FTA in the second)[67] could impose safeguards against other members of the PTA where it belongs; they held that members of a PTA can impose safeguards against other members of a PTA, provided that they respect a parallelism: they can do so if they have counted PTA imports when assessing injury; they cannot do so, however, in the opposite case (when they have not counted PTA imports when assessing injury). Although the WTO adjudicating bodies explicitly declared that they were not influencing the relationship between the two provisions (GATT Articles XIX and XXIV), de facto they did. Had they followed a 'narrow' reading of the list in parenthesis, it would have been impossible to open the door to safeguards between PTA members. Following these events, one can reasonably conclude that WTO

[63] GATT Doc. B.I.S.D. 6S/70, 97. [64] GATT Analytical Index, 820ff.
[65] WTO Doc. WT/REG/W/17/Rev. 1, 4. [66] *Argentina—Footwear (EC).*
[67] *US—Wheat Gluten.*

practice supports the view that the list in parenthesis of GATT Article XXIV.8 is not exhaustive.

Including the possibility for intra-PTA safeguards *ipso facto* suggests that the list featured in parenthesis is indicative in nature. Assuming that this is the case, the next question is what else should be included? The items included (in the enlarged parenthesis) should inform the interpreter about the other items that should be included. Yet, there is remarkable heterogeneity with respect to the subject matter of the provisions included in parenthesis. Indeed, whereas the first five provisions mentioned deal with trade instruments, GATT Article XX covers a wide range of domestic instruments. Should we understand the term 'other restrictive regulations of trade' as extending to cover any domestic instrument that restricts trade? We have already responded briefly in the negative to this question. Here is some detail explaining why this should be the case.

The 1970 Working Party on *EEC—Association with African and Malgasy States* dealt with this issue. There, the opinion was raised that trade had not been substantially liberalized, in view of the continued imposition by certain parties to the Convention (the Association of EEC with African and Malgasy States) of fiscal charges on imports from other members. The members of the PTA responded by arguing that:

> the provisions of Article XXIV, concerning the concept of a free-trade area concerned only protective measures. The taxes referred to were of a fiscal character, not protective.[68]

Where the line between 'protective' and 'fiscal' should be drawn was not discussed (or explained) any further. A series of PTAs now include standards on environmental protection, labour standards, human rights, etc. The question could arise as to whether members of a PTA could adopt say two sets of environmental policies, one applicable to its PTA partners, and one applicable to the rest of the world.

There are good arguments to support the thesis that the term 'other restrictive regulations of commerce' should be confined to trade instruments only. The purpose of GATT Article XXIV is to reduce protection for a subset of the WTO membership, that is, WTO members participating in a PTA. Since quantitative restrictions (QRs) are illegal, and domestic instruments are non-negotiable and have to abide by the non-discrimination obligation, the only permissible (legal) protection in the GATT is protection through tariff protection: consequently, the only advantage that WTO members can give each other when forming a PTA should be a tariff advantage.

For the rest, WTO members must respect the MFN obligation. Case law has by now repeatedly acknowledged that the very purpose of the discipline on domestic instruments is to safeguard the value of tariff concessions, and not to protect. The Appellate Body, in its report on *Japan—Alcoholic Beverages II*, confirmed this understanding (at 16):

> The broad and fundamental purpose of Article III is to *avoid protectionism* in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures not be applied to imported or domestic

[68] GATT Doc. B.I.S.D. 18S/133, 135–7.

> products so as to afford protection to domestic production." Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products [emphasis added].

Domestic instruments are not meant to protect domestic production. Since they are not meant to protect domestic production, then it is impossible for a member of a PTA to be allowed to give one sub-set of the WTO membership an advantage that it does not extend to the remaining membership.[69]

It is quite striking that after all these years of intense practice WTO members have not managed to agree on a more precise definition of the term 'substantially all trade'. The explanation probably lies in the missing incentive to do so. From a pure trade perspective, the less PTA partners liberalize trade between them, the better off outsiders are, since the resulting trade diversion will be less important than it would have been had PTA partners integrated their markets in a more meaningful way.

Moreover, specifying the SAT requirement might prove to be a Damocles sword for outsiders since they can only profit from the current 'fuzziness' assuming they want to go preferential in the future. Consequently, for both trade as well as strategic reasons outsiders are better off with the current situation. If we consider that the only remaining WTO member with no PTA until 2014, Mongolia, this year signed an FTA with Japan, the strategic reasons for doing nothing can be even better understood.

4.3 External protection cannot be raised

Broadly speaking, by virtue of this requirement (referred to in the literature as the 'external requirement'), WTO members should not, when entering into a PTA, raise their protection vis-à-vis the remaining WTO membership. Contrary to what is the case with respect to the internal requirement, the conditions for meeting the external requirement are different for FTAs and CUs. With respect to FTAs, GATT Article XXIV.5(b) reads:

> [D]uties and other regulations of commerce . . . shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area . . .

GATT Article XXIV.5(b) does not explicitly state that WTO members participating in an FTA cannot modify their external protection when joining the FTA, although wording of this sort would have been dictated by the very nature of an FTA. FTAs aim at liberalizing trade within their constituents only, without addressing external

[69] Compare James Mathis 'Regional Trade Agreements and Domestic Regulation: What Reach for "Other Restrictive Regulations of Commerce"?' in Lorand Bartels and Federico Ortino, eds., *Regional Trade Agreements and the WTO Legal System* (Oxford: Oxford University Press, 2006) 79–108 who expressed similar thoughts on this score, as well as various other contributions in Bartels and Ortino, *Regional Trade Agreements and the WTO Legal System* (2006) that do not necessarily share this view. Jong Bum Kim, 'WTO Legality of Discriminatory Liberalization of Internal Regulations: Role of RTA National Treatment' (2001) *World Trade Review* 10, 473–96 reaches the same outcome based on the necessity requirement as explained by the Appellate Body in *Turkey—Textiles*: on this view, two sets of domestic instruments, one for PTA partners and one for outsiders, is not necessary.

protection at all. FTA members continue to unilaterally define their foreign commercial policy, even after they have joined an FTA. Still, the wording of this provision suggests that changes are possible. Note that the obligation enshrined in this legal provision does not refer to duties and other regulations of commerce as a whole, but to individual instruments. The obligation assumed is not to come to more or less the pre-FTA situation by rebalancing various instruments. It is to ensure that each and every individual trade instrument will not become more restrictive, post-establishment of the FTA.

What is the level of comparison though? Should it be the level of applied or bound duties practised in the period before the establishment of the FTA? The Understanding on the Interpretation of GATT Article XXIV allows WTO members entering into an FTA to raise their level of duties from the applied level to the bound level, assuming discrepancy between the two levels. Hence, those forming a PTA can afford each other an extra margin of preference, that captured by the difference between the level of the applied and that of the bound duty.

Note that, in contrast to GATT Article XXIV.8, this provision refers to other regulations of commerce, and not to other restrictive regulations of commerce, the latter, prima facie at least, being a sub-set of the former. GATT Article XXIV.5(b) contains neither an indicative nor an exhaustive list of regulations of commerce (other than duties). It should not be in doubt though that ODCs (other duties and charges) should be covered by this provision. The question is of course, what else? The other instrument most likely to change as a result of the establishment of a PTA is the rules of origin.

Rules of origin are of particular interest in the FTA context. Unless goods are accompanied by a certificate of origin, exporters will have an incentive to ship to the cheapest port of entry in an FTA (since external protection remains a matter for national sovereignty, and it could very well be the case that there are asymmetries as to the level of customs duties across FTA members).

Rules of origin have on occasion been discussed in the context of GATT Article XXIV.5.[70] Since PTAs are meant to allow the conferral of WTO-consistent preferences, the rules of origin contracted in the context of a PTA should be more favourable (or at the very least, not more burdensome) than those applied on an MFN basis. And yet, as our earlier discussion shows, it is difficult to state whether this has indeed been the case across PTAs.

Preferential rules of origin have been excluded from the mandate of the Harmonized Working Programme (for rules of origin). They are also quite asymmetric and often difficult to use. This is one area where improvements and simplifications of procedures are definitely necessary.[71]

[70] WTO Doc. TN/RL/W/8/Rev. 1 of 1 August 2002. The General Council decision mentioned earlier (WTO Doc. WT/L/806 of 16 December 2010) explicitly refers to the obligation to notify rules of origin when notifying a PTA.

[71] Jaime Serra, Guillermo Aguilar, Jose Cordoba, Gene Grossman, Carla Hills, John Jackson, Julius Katz, Pedro Noyola, and Michael Wilson, *Reflections on Regionalism; Report of the Study Group on International Trade, Carnegie Endowment for International Peace* (Washington DC: The Brookings Institution Press,

With respect to CUs, GATT Article XXIV.5(a) reads:

> [D]uties and other regulations of commerce . . . shall not *on the whole* be higher or more restrictive than *the general incidence* of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union . . . [emphasis added].

The italicized words mark the difference between the text of GATT Article XXIV.5(b), and that of GATT Article XXIV.5(a): 'on the whole' and 'general incidence' invite a comparison of the general (and not item-by-item) situation before and after the formation of the CU. This was the intention of the drafters:

> The phrase "on the whole" . . . did not mean that an average tariff should be laid down in respect of each individual product, but merely that the whole level of tariffs of a customs union should not be higher than the average overall level of the former constituent territories.[72]

> The Sub-Committee recommended that the words "average level of duties" be replaced by "general incidence of duties" in paragraph 2(a) of the new Article. It was the intention of the Sub-Committee that this phrase should not require a mathematical average of customs duties but should permit greater flexibility so that the volume of trade may be taken into account.[73]

Subsequent practice sides with the view that an item-by-item approach is unwarranted in the context of GATT Article XXIV.5(a). There is, nonetheless, disagreement as to the precise level on which comparisons will take place. The report of the 1983 Working Party on Accession of Greece to the European Communities reflects the view expressed by the EU, that:

> Article XXIV.5 required only generalized, overall judgment on this point.[74]

By the same token, the report of the 1988 Working Party on Accession of Portugal and Spain to the European Communities includes the view of the EU that:

> Article XXIV.5 only required an examination on the broadest possible basis.[75]

This view, however, failed to convince other members of the Working Party. One member

> could not accept the Communities' contention that the extension of the tariff of the EC/10 to the EC/12 was compatible with their obligations under Article XXIV.5(a) regardless of the effect on the tariffs of Spain and Portugal. Article XXIV.5(a) required a comparison with the pre-accession tariffs of the constituent territories and the relative size of those territories was not a relevant factor.[76]

1997) show that rules of origin are one of the most important causes of trade diversion. We have provided studies in this chapter on their economic impact.

[72] GATT Doc. EPCT/C.II/38 at 9 reproduced in the *GATT Analytical Index: Guide to GATT Law and Practice*, updated 6th edn. (GATT, 1995) 803.

[73] Havana Reports reproduced in the *GATT Analytical Index*, 803.

[74] See GATT Doc. B.I.S.D. 30S/168, 184.

[75] See GATT Doc. B.I.S.D. 35S/293, 295–6.

[76] Ibid. 311.

Disagreements arose often among members of the Working Party as to whether bound or applied rates should be used in the context of GATT Article XXIV.5(a).[77] This issue has been clarified with the entry into force of the WTO Understanding on the Interpretation of GATT Article XXIV:

> The evaluation under paragraph 5(a) of Article XXIV of the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union shall in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected. This assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin. The Secretariat shall compute the weighted average tariff rates and customs duties collected in accordance with the methodology used in the assessment of tariff offers in the Uruguay Round of Multilateral Trade negotiations. For this purpose, the duties and charges to be taken into consideration shall be the *applied rates* of duty. It is recognized that for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required [emphasis added].[78]

It follows, that it is applied rates that matter when a CU is established. There is an additional provision for CUs embedded in GATT Article XXIV.6:

> If, in fulfilling the requirements of subparagraph 5(a), a contracting party proposes to increase any rate of duty inconsistently with the provision of Article II, the procedure set forth in Article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reduction brought about in the corresponding duty of the other constituents of the union.

GATT Article XXIV.6 deals only with customs duties and not other regulations of commerce. An example may help to illustrate the function of this Article. Assume that A, B, and C decide to enter into a CU. Assume that before the formation of the CU the tariff protection (to avoid any unnecessary complications, assume equivalence between bound and applied rates) of the automotive sector in the three countries was the following:

A 20%
B 30%
C 40%

[77] See, for example, the discussions of the Working Party examining the compatibility of the EEC with Art XXIV, GATT Doc SR.18/4, 46–54 and also in C/M/8, SR.19/6–7; see the Working Party report on *Accession of Greece to the European Communities*, n. 73 at 175; see also the 1991 Working Party report on *Free Trade Agreement Between Canada and the United States*, B.I.S.D. 38S/47, 66.

[78] It is interesting that the Understanding focuses on *applied* as opposed to *bound* duties. By adopting this focus, it is going further than simply stating that WTO members cannot use a CU to undo tariff obligations that were previously bound; it is also stating that WTO members cannot use a CU to jointly raise applied tariffs. This is interesting because one prediction of the theory would be that a CU would have the incentive to set higher external tariffs than the members would acting individually (i.e. before the CU) and that this would be one bad thing about the CU in terms of its multilateral effects. So from the multilateral perspective, this rule makes sense.

A, B, and C, bind customs duties on cars at 30 per cent at the CU level. Arguably, they have met their obligations under GATT Article XXIV.5(a). They have not, however, necessarily met their obligations under GATT Article XXIV.6 as well. When GATT Article XXIV.5(a) is violated, GATT Article XXIV.6 will be *ipso facto* violated as well. Compliance with GATT Article XXIV.5(a), on the other hand, does not automatically lead to compliance with GATT Article XXIV.6. Compliance with GATT Article XXIV.5(a) is, in other words, a necessary but not sufficient condition for compliance with GATT Article XXIV.6. GATT Article XXIV.6 comes into play any time a member of a CU (in our illustration, A) has to raise its pre-CU duty to meet the duty at the CU level.

In similar cases, GATT Article XXVIII negotiations will kick in. This means that WTO members which qualify as initial negotiating right holders (INRs) or principal supplying interest countries (PSIs) will participate in the negotiations with the members of the CU; such negotiations aim to compensate those WTO members for which access to A's market has been made more difficult as a result of the formation of the CU. GATT Article XXIV.6, second sentence makes it clear that built-in compensation will be taken into account.

An obligation to compensate will exist only if the built-in compensation does not suffice to take care of the injury suffered as a result of A's new, higher duties. Let us go through two factually different scenarios to illustrate this point.

First scenario: A is a low per capita income small country, whereas C is a high per capita income large country. Neither A nor C produces cars. The fact that C lowers its duties from 40 per cent to 30 per cent will, in all likelihood, over-compensate the fact that A raised its own duties from 20 per cent to 30 per cent. This is the notion of built-in compensation. C will import so many more cars than before, that exporters will be compensated for their losses resulting from fewer exports to A.

Second scenario: A is the high per capita income large country, whereas C is the low per capita income small country. In this case, the amount of trade lost because A had to raise its duties is, most likely, not compensated by the fact that C lowered its own duties. In such cases, there is nothing like sufficient built-in compensation. Hence, something needs to be done. GATT Article XXIV.6 calls for compensation which will be offered to the WTO members following a GATT Article XXVIII negotiation.[79]

5. PTAs in WTO Dispute Settlement

When judged against its original mandate (to review consistency of notified PTAs with the relevant multilateral rules), the multilateral review has been a failure by any reasonable benchmark. Over 400 PTAs have been notified to the WTO, over 350 of which are under GATT Article XXIV, almost two-thirds of which are now in force,[80]

[79] Hoda (2001) discusses practice in this context.

[80] According to the WTO 2011 World Trade Report dedicated to PTAs ('The WTO and Preferential Trade Agreements: From Coexistence to Coherence'), 300 PTAs were in force in 2010, whereas there were only seventy in 1990.

and on only a handful of occasions have the WTO organs managed unanimously to decide on the consistency of the notified scheme.

Schott[81] identifies four cases where PTAs were judged broadly consistent with the GATT. Since his study the CU between the Czech and the Slovak republics has been judged GATT-consistent. This is a highly idiosyncratic case though, since the establishment of the CU was the interregnum between the dissolution of a unitary state (Czechoslovakia) and the accession of its two constituent parts to the EU. We are simply in the dark as to the GATT-consistency of all other remaining PTAs. And there are many. The overwhelming majority of Article XXIV Working Party reports reflect a disagreement among its members.

Hudec[82] noted:

> The seeming collapse of the MFN rules is probably the single most important cause of the present day pessimism about the GATT substantive rules.

Hudec, twenty years later[83] remarks:

> [T]he GATT's somewhat benign attitude toward RAs is merely one part of this larger tolerance toward departures from MFN in general.

Roessler[84] is in agreement:

> The record under the current procedures is not encouraging. During the past three decades about 50 working parties have been established to examine RIAs. None of them was able to reach a unanimous conclusion on the GATT-consistency of the agreement examined.

The advent of the Transparency Mechanism, as we saw earlier, signalled the end of reports aiming to decide on the consistency of PTAs. Before, as well as after its advent, WTO members could always challenge the consistency of PTAs before WTO adjudicating bodies. Case law is quite clear on this. Voices have been heard in literature though, arguing that, acknowledging to Panels the power to adjudicate on the overall consistency of PTAs with the multilateral rules, would undo the institutional balance across WTO organs as struck by the WTO framers. The Appellate Boby has put to rest similar arguments which, are, nonetheless, worth recounting in light of their (potential) repercussions on other issues as well.

Roessler[85] has argued that, for reasons having to do with the institutional balance of the WTO, a limited judicial review by WTO adjudicating bodies is the most appropriate

[81] Jeffrey Schott, 'More Free Trade Areas?' in Jeffrey Schott, ed., *Free Trade Areas and US Trade Policy* (Washington D.C.: Institute of International Economics, 1989) 1–58.

[82] Robert E. Hudec, 'GATT or GABB? The Future Design of the General Agreement on Tariffs and Trade' (1972) *Yale Law Journal* 80, 1299–386.

[83] Robert E. Hudec, 'GATT's Influence on Regional Agreements: A Comment' in Jaime de Melo and Arvind Panagariya, eds., *New Dimensions in Regional Integration* (Cambridge M.A.: Cambridge University Press, 1993) 151–5.

[84] Frieder Roessler, 'The Relationship between Regional Integration Agreements and the Multilateral Trade Order' in Kym Anderson and Richard Blackhurst, eds., *Regional Integration and the Global Trading System* (Exeter: Harvester Wheatsheaf, 1993) 311–25.

[85] Frieder Roessler, 'The Institutional Balance between the Judicial and the Political Organs of the WTO' in Marco C. E. J. Bronckers and Reinhard Quick, eds., *New Directions in International Economic Law—Essays in Honour of John H. Jackson* (The Hague: Kluwer Law International, 2000) 325–47.

one. A similar argument was raised by India in *India—Quantitative Restrictions*. India had argued that the question of whether a restriction could be justified on balance of payments grounds was inherently political. Borrowing from the political question doctrine, familiar to some legal orders, India argued that a comprehensive review of such issues should be entrusted to WTO Committees and not to Panels. In other words, the overall consistency of a PTA with the WTO should be the exclusive *domaine reservé* of the CRTA. The Appellate Body rejected India's argument, essentially on textual grounds.[86] The wording of the Understanding on GATT Article XXIV supports this view (§12):

> The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of those provisions of Article XXIV relating to customs unions, free-trade areas or interim agreements leading to the formation of a customs union or a free-trade area.[87]

Hence, in theory the issue of consistency of a PTA could be simultaneously before a Panel and the CRTA, and the two could reach divergent conclusions on the same issue unless some sort of coordination mechanism is introduced.

Of course, this is a non-issue for all PTAs notified after the advent of the Transparent Mechanism. The CRTA will no longer consider the consistency of PTAs. It is none-theless, an issue for past PTAs for which reports have been issued. Can a challenge against PTAs examined before 2006 now be brought before a Panel? The Panel on *EEC—Imports from Hong Kong* held that:

> It would be erroneous to interpret the fact that a measure had not been subject to Article XXIII over a number of years, as tantamount to its tacit acceptance by contracting parties.

In the absence of statutory prescription and in light of this ruling it is worth examining this issue a bit further. There is no obligation to suspend Panel proceedings while an issue is being discussed before the CRTA (*lis pendens*).[88] The Panel on *US—Line Pipe* did not stop its review only because the CRTA had not issued its report at the time the dispute was submitted to it (§7.144):

> Concerning Article XXVIII:8(b), we do not consider the fact that the CRTA has not yet issued a final decision that NAFTA is in compliance with Article XXIV:8 is sufficient to rebut the prima facie case established by the United States. Korea's argument is based on the premise that a regional trade arrangement is presumed inconsistent with Article XXIV until the CRTA makes a determination to the

[86] See *India—Quantitative Restrictions* at §§98ff.

[87] Roessler, 'The Institutional Balance between the Judicial and the Political Organs of the WTO', n. 85 argues that the terms of the Understanding lean towards a restrictive understanding of its scope: the reference made is to the application of GATT Art. XXIV and not to GATT Art. XXIV as such. It is nonetheless quite difficult to distinguish between the two.

[88] DSU Art. 12.12 allows the complaining party to request suspension of Panel proceedings. This is a right bestowed upon the complainant, and not an obligation to behave in this way assuming certain contingencies (for example, discussions of the issue before a WTO committee) have been met.

> contrary. We see no basis for such a premise in the relevant provisions of the Agreements Establishing the WTO.

If the CRTA concludes by consensus (irrespective whether it concluded on the consistency or the inconsistency of the notified PTA with the multilateral rules), there are good reasons to believe that the Panel subsequently dealing with the issue will follow the opinion reflected in the CRTA. The Panel on *India—Quantitative Restrictions,* which, dealt with a similar issue[89] held at §5.94:

> [W]e see no reason to assume that the panel would not appropriately take those conclusions into account. If the nature of the conclusions were binding . . . a panel should respect them.

There is, however, no legal compulsion for the Panel to follow a CRTA decision. Should Panels stop short of deciding whether a PTA is WTO-consistent, if the CRTA has not yet pronounced on its consistency? This is a non-issue nowadays since, as already stated, the CRTA no longer pronounces on the consistency of notified PTAs. On the other hand, should the CRTA be bound by a Panel's (and/or Appellate Body's) decision on the consistency of a PTA with the relevant WTO rules? This seems to be a likelier scenario in light of the time constraints that Panels have to adhere to and the absence of such constraints when the CRTA reviews a scheme. The formal answer has to be, once again, no. The legal effect of the judiciary's decision is not such that it acknowledges the force of *res judicata* (binding any discretion of the CRTA to subsequently deviate from its reasoning/outcome). But, once again, this is a non-issue in light of the current mandate of the CRTA following the advent of the Transparency Mechanism.

The view that the consistency of PTAs with the multilateral rules can be the subject of judicial review was endorsed by GATT contracting parties, long before the Appellate Body explicitly accepted that this is the case. A representative view is offered by the EU delegate, and is reflected in the report issued by the 1978 Working Party on the Agreement between the EEC and Egypt:

> [A]s regards the possibility of consultations with the contracting parties concerning the incidence of the Agreement on their trade interests . . . nothing prevented these countries from invoking the relevant provisions of the General Agreement, such as Articles XXII and XXIII.[90]

During the GATT years (1948–94), three Panels were established to examine claims relating to the consistency of a PTA with the multilateral rules.[91] Two reports were

[89] The issue before this Panel was to what extent a Panel dealing with an issue which had already been decided by the WTO Balance of Payments Committee should follow the decision reached in this Committee.

[90] GATT Analytical Index, 781.

[91] The first, after a request by Canada in 1974 in connection with the accession to the European Community of Denmark, Ireland, and the United Kingdom (GATT Doc. C/W/250) was not activated because the parties to the dispute reached an agreement (GATT Doc. C/W/259). The second, led to an un-adopted Panel report in *EC—Citrus*, GATT Doc. L/5776. The third report is on *EEC—Bananas II*, GATT Doc. DS38/R of 11 February 1994 which also remains un-adopted.

issued and they both remain un-adopted. The first of these, the *EC—Citrus* Panel report argues in favour of an examination (by Panels) of individual measures only, and, based on this position, refused to pronounce on the overall consistency of the PTA with the multilateral rules. The Panel did not see its role as a surrogate to the (then) Article XXIV Working Parties:

> The Panel noted that at the time of the examination of the agreements entered into by the European Community with certain Mediterranean countries, there was no consensus among contracting parties as to the conformity of the agreement with Article XXIV.5
>
> . . .
>
> The agreements had not been disapproved, nor had they been approved. The Panel found therefore that the question of conformity of the agreements with the requirements of Article XXIV and their legal status remained open.[92]

This report remains un-adopted, and hence, of limited legal relevance.

EEC—Bananas II is the second report in this vein. This report made one important interpretative contribution by holding that there is one way preferential arrangements are per se inconsistent with GATT Article XXIV. Obligations to liberalize must be assumed by all participants (§159):

> This lack of *any* obligation of the sixty-nine ACP countries to dismantle their trade barriers, and the acceptance of an obligation to remove trade barriers only on imports into the customs territory of the EEC, made the trade arrangements set out in the Convention substantially different from those of a free trade area, as defined in Article XXIV:8(b).

Unsurprisingly, the same Panel went on to conclude (§164) that the Lomé Convention (the Agreement between the EU and a series of African, Caribbean, and Pacific states) did not meet the requirements of GATT Article XXIV. This report remains un-adopted as well and, although the view expressed in the cited passage is sound, the legal value of the report is minimal.[93]

During the WTO era, practice in this area continues to be scarce. The Panel on *Turkey—Textiles* records the most comprehensive yet discussion concerning the ambit of judicial review of a PTA by Panels. India had argued before the Panel that it had suffered damage as a result of Turkey's decision to erect new barriers to its textiles exports, following the signature and the entry into force of the CU between the EU and Turkey. India argued that its MFN rights had been impaired as a result. Turkey did not deny that this had indeed been the case (that is, that it had erected new barriers), but invoked GATT Article XXIV to justify its deviation from MFN. The Panel first addressed the question whether it was competent to discuss the overall consistency of a PTA with the GATT. Responding to an argument by the complainant, it held that WTO adjudicating bodies are competent to examine PTA-related issues, but should stop short of providing an overall assessment regarding the

[92] GATT Doc. L/5776, dated 7 February 1985, §4.6 and §4.10.
[93] In the WTO era the Appellate Body report on *EC—Bananas III* reproduced almost *verbatim* this view.

consistency of a PTA with the WTO. This Panel followed the findings in the Panel report on *EC—Citrus* (§§9.52 to 9.53):

> As to the second question of how far-reaching a panel's examination should be of the regional trade agreement underlying the challenged measure, we note that the Committee on Regional Trade Agreements (CRTA) has been established, *inter alia*, to assess the GATT/WTO compatibility of regional trade agreements entered into by Members, a very complex undertaking which involves consideration by the CRTA, from the economic, legal and political perspectives of different Members, of the numerous facets of a regional trade agreement in relation to the provisions of the WTO. It appears to us that the issue regarding the GATT/WTO compatibility of a customs union, as such, is generally a matter for the CRTA since, as noted above, it involves a broad multilateral assessment of any such custom union, i.e. a matter which concerns the WTO membership as a whole.
>
> . . .
>
> As to whether panels also have the jurisdiction to assess the overall WTO compatibility of a customs union, we recall that the Appellate Body stated that the terms of reference of panels must refer explicitly to the "measures" to be examined by panels. We consider that regional trade agreements may contain numerous measures, all of which could potentially be examined by panels, before, during or after the CRTA examination, if the requirements laid down in the DSU are met. However, it is arguable that a customs union (or a free-trade area) as a whole would logically not be a "measure" as such, subject to challenge under the DSU [italics in the original].

On appeal, the Appellate Body held a different view arguing that those availing themselves of justifying their measures through recourse to GATT Article XXIV must explain why their PTA is GATT-consistent. Consequently, Panels should always have the power to discuss the overall consistency of PTAs with the multilateral rules (§§58 to 59):

> First, the party claiming the benefit of this defense must demonstrate that the measure at issue is introduced upon the formation of a customs union that *fully meets the requirements of sub-paragraph 8(a) and 5(a) of Article XXIV*. And second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue.
>
> . . .
>
> We would expect a panel, when examining such a measure, to require a party to establish that both of these conditions have been fulfilled. It may not always be possible to determine whether the second of the two conditions has been fulfilled without initially determining whether the first condition has been fulfilled [emphasis added].

More recently, the Panel on *US—Line Pipe* faced an argument by the United States that, as a member of NAFTA, it was entitled to treat imports from NAFTA differently than imports from non-NAFTA sources when imposing a tariff quota. The Panel repeated that the United States had the burden of proof to show consistency of NAFTA with GATT Article XXIV (§7.142); it then addressed the issue of the quantum of proof (burden of persuasion) that the party carrying the burden of proof has to

provide in order to establish a prima facie case of the consistency of a PTA with the multilateral rules (§7.144):

> In our view, the information provided by the United States in these proceedings, the information submitted by the NAFTA parties to the Committee on Regional Trade Agreements ("CRTA") (which the United States has incorporated into its submissions to the Panel by reference), and the absence of effective refutation by Korea, establishes a prima facie case that NAFTA is in conformity with Article XXIV:5(b) and (c), and with Article XXIV:8(b).

The information provided by the United States in the proceedings is confined to a statement (§7.142) that duties on 97 per cent of the NAFTA parties' tariff lines would be eliminated within ten years from the inception of NAFTA, whereas, with respect to other regulations of commerce, a reference to the principles of national treatment, transparency, and a variety of other market access rules is made. In the Panel's view, the submitted information was enough to make a prima facie case of consistency of NAFTA with GATT Article XXIV. In subsequent cases as well (*Argentina—Poultry Antidumping Duties*, *Mexico—Taxes on Soft Drinks)*, Panels have confirmed the view that they have the power to decide on the overall consistency of notified PTAs with the multilateral rules.

Only a handful of Panels have so far been established in order to discuss the consistency of PTAs with the multilateral rules, and this is certainly not many when one takes into account the sheer number of PTAs and the absence of meaningful review by the CRTA over the years. Moreover, serious procedural hurdles were removed with the advent of the WTO and the recent case law: Panels are now established at the sole request of the complainant, and the original burden of proof is easy to meet (the complainant is required to demonstrate deviation from MFN and, upon such demonstration, the burden of proof shifts to the defendant); it is the defendant that will have to demonstrate the overall consistency of the PTA with the GATT rules.

So why have WTO members continued to do nothing?[94] Historically, the first integration was that of Europe and there should be no doubt that the ECSC (European Coal and Steel Community) was a blatant violation of GATT rules since it integrated markets only with respect to two goods. No one wanted to question the wider European integration process though, by putting into question the GATT-consistency of the ECSC. Contracting parties, having committed the original sin (by demonstrating a benign attitude towards the European integration), refrained from changing their attitude subsequently for fear of being judged to be inconsistent. Finger[95] has defended this line of argument. Baldwin[96] revisits the discussion regarding the original sin and

[94] This section of the chapter is largely based on Mavroidis (2006). See also Limão, 'Preferential Trade Agreements as Stumbling Blocks for Multilateral Trade Liberalization: Evidence for the U.S.', n. 15 on these issues, as well as Philip Levy and T. N. Srinivasan, 'Regionalism and the (Dis)advantage of Dispute-Settlement Access' (1996) *American Economic Association Papers and Proceedings* 86(2), 93–8.

[95] Michael J. Finger, 'GATT's Influence on Regional Agreements' in De Melo and Panagariya, eds., *New Dimensions in Regional Integration* (1993), n. 83 at 128–58.

[96] Richard E. Baldwin, 'Sequencing and Depth of Regional Economic Integration: Lessons for the Americas from Europe' (2008) *The World Economy* 31, 5–30.

concludes that other schemes such as the US–Canada Auto Pact also contributed to an initial tolerance towards PTAs. Eventually, some of these suspect schemes would benefit from waivers.

A risk-averse WTO member would rationally choose not to challenge a PTA because:

(a) there is a collective action problem;
(b) strategic reasons might argue against a challenge; and
(c) the agency design for WTO adjudicating bodies probably does not inspire challenges of this sort.

Absence of multilateral review and absence of litigation have led to tolerance of PTAs. Voices are now being raised to the effect that this is untenable situation that needs to be addressed with immediate effect. Yet, the empirical analysis by Horn et al.[97] suggests that the subject matter of PTAs only partially overlaps with that of the WTO: some of the content of PTAs cannot in any case be multilaterally reviewed in the absence of rules to this effect. On the other hand, Mavroidis[98] notes that the size of the problem is much smaller than it used to be since MFN tariffs have been lowered over the years. Moreover, what to do with existing PTAs? Is it feasible to devise a solution that will be applied *ex nunc*? We are yet some way to addressing this issue which is intimately linked to the future of the WTO since PTAs seem to run away with the trade agenda while the WTO is mulling over the completion of the Doha Round.

[97] Henrik Horn, Petros C. Mavroidis, and André Sapir, 'Beyond the WTO: An Anatomy of the EU and US Preferential Trade Agreements' (2010) *The World Economy* 33, 1565–88.

[98] Petros C. Mavroidis, 'Always Look at the Bright Side of Non-delivery: WTO and Preferential Trade Agreements, Yesterday and Today' (2011) *World Trade Review* 10, 375–87.

15

Export Measures and Controls

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1. Introduction

Export measures in international trade are now a major concern and an important topic of dispute settlement in the WTO system. The export side of trade no less than the import side may be a source of economic distortions and inefficiencies. Two general categories of export measures may be distinguished: (1) export incentives and (2) export controls. Export incentive measures include export subsidies, export finance, tax and export duty drawbacks, export processing zones, and export promotion activities. Export control measures may take many forms: duties, taxes, quotas, embargos and bans, licensing requirements, and minimum export prices. The export incentive side is the subject of the WTO Subsidy and Countervailing Measures Agreement, which is covered elsewhere in this book. In this chapter we address the rules of international law governing export control measures.

Historically the WTO negotiations and the multilateral trading system has concerned itself principally with the import side of trade, such subjects as tariff reductions and reduction in non-tariff trade barriers to market access. As a result, most import

tariffs levied by WTO members are now bound at historically low rates and imports benefit from an array of WTO rules stemming from WTO agreements. In contrast, the WTO has never systematically addressed and developed a comprehensive system of rules dealing with export control measures. As long ago as 1978, economist Fred Bergsten[1] called for GATT negotiations to comprehensively address international rules governing export controls, but this call was not heeded.

In the first decade of the twenty-first century, export controls became a widespread matter of concern. The Organisation of Economic Cooperation and Development (OECD) in a study[2] published in 2009, found that export duties were applied by sixty-five WTO countries over the period 2003–09. These export duties were introduced primarily by developing and least developed countries and were mostly applied to exports of agricultural products, minerals, metals, and natural resources.[3] The WTO has also voiced concern about the recent spread of export control measures, stating 'one salient point in trade monitoring over the past six months has been the confirmation of an increasing trend in export restrictions. . . . These measures include export taxes in response to rising prices for agricultural products and export quotas on metals and mineral products with a view to securing domestic supply and to addressing resource depletion.'[4]

Export control measures have distorting economic impacts and typically cause an efficiency loss in both the exporting and importing countries. Export duties and restrictions reduce export volumes thereby artificially raising the prices of exported products. Reduced exports in turn may divert some supply to the domestic market of the restricting state, leading to artificially depressed domestic prices. This supply-side disparity of prices in domestic and international markets may tighten supplies of the particular commodity and cause market and investment disruptions. Consumption distortions stem from the fact that too much of the taxed product is consumed domestically and too little is consumed by foreign consumers. Production distortions result from the fact that the trade restrictions cause too much to be produced in the trade restricting state's downstream industry, while too little is produced in importing states' downstream industries. Export restrictions also can adversely affect investment and production response conditions. Price volatility and unstable supplies caused by export restrictions create an insecure business environment. For example, in 2013, Indonesia, which produces over one third of the world's tin, taxed exports in an effort to drive business to local smelters. Within a week, world tin prices climbed over 5 per cent and foreign investors pulled money out of Indonesia, sending Jakarta's stock market tumbling and driving the rupiah down 16 per cent against the dollar.[5]

Exports of goods, services, technology, and even capital are, to some degree, regulated by states. Such regulation furthers not only economic objectives but also political and national security objectives. Export controls may, for example, be used to: (1)

[1] C. Fred Bergsten, *Completing the GATT: Toward New International Rules to Govern Export Controls* (London: British-North American Committee, 1974).

[2] OECD Trade Policy Working Paper No. 101(Paris: OECD, 2009).

[3] Ibid. 1.

[4] WTO Report on G-20 Trade Measures (May 2011), available at <http://www.wto.org/g20report>.

[5] 'Indonesia's Trade Rules Roil Tin Market', *The Wall Street Journal*, 6 September 2013.

conserve domestic commodities that are in short supply; (2) conserve natural resources; (3) combat domestic price rises or maintain domestic price controls; (4) maintain world prices of a commodity by withholding supplies; (5) develop processing industries;[6] (6) enforce 'voluntary' export restraints at the behest of an importing country;[7] (7) limit the military or economic capability of another country; (8) sanction a country or induce it to change its policies; and (9) comply with internationally mandated obligations.[8]

GATT norms apply to export regulations in four basic ways. First, the rules regarding most favoured nation (MFN) treatment (Article I) and national treatment (Article III) apply to exports as well as imports. Second, GATT customs rules such as fees and formalities (Article VIII), transparency and notification (Article X), and marks of origin (Article IX) apply to exports. Third, as we have seen,[9] export promotional activity may implicate WTO rules concerning antidumping and countervailing duties. Fourth, export requirements, when used to condition foreign investment, may infringe the WTO Agreement on Trade Related Investment Measures.[10]

In most cases, however, the issue of the legality of export restrictions will involve GATT Article XI, which is the key provision involving export restrictions since it was broadly interpreted in the *Japan—Trade in Semi-Conductors* case to cover all trade 'measures' whether affecting exports or imports.[11] Article XI, however, is riddled with exceptions, and GATT Articles XX and XXI specify additional exceptions, both generally and for national security. We examine this somewhat irrational system below.

2. Cases

Compared to cases involving import issues, export disputes are relatively rare so that jurisprudence is sparse. Nevertheless, five important disputes[12] have been decided under the GATT/WTO dispute settlement mechanism that bear extended discussion.

In *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*,[13] a case decided by a GATT Panel, the United States contested regulations maintained by Canada which prohibited the exportation or sale for exportation of unprocessed herring and pink and sockeye salmon. Such fish could be exported only if canned,

[6] For example, Brazil in the 1960s levied export taxes on unprocessed coffee beans to give domestic processors an advantage.

[7] For example, in 2005, China introduced export taxes on textile products to head off import quotas being introduced by the EU and United States after the expiration of the WTO Agreement on Textiles and Clothing. The ensuing row was settled by agreement.

[8] Examples of the latter point are export restrictions undertaken to comply with the Basel Convention on the Transboundary Movement of Hazardous Wastes and Their Disposal; the Convention on International Trade in Endangered Fauna and Flora; and the Montreal Protocol on Substances that Deplete the Ozone Layer.

[9] See Chapters 12 and 13. [10] See Chapter 19.

[11] See *Japan—Trade in Semi-Conductors*, adopted 4 May 1988, GATT B.I.S.D. (35th Supp.), 116 (1989). See also Chapter 6.

[12] We do not cover in this regard the case *United States—Measures Treating Export Restraints as Subsidies*, Panel report, WT/DS 194/R, adopted 23 August 2001. This case ruled that export restraints cannot amount to a financial contribution in the sense of Art. 1.1(a) of the SCM Agreement. Thus export restraints are not to be considered as subsidies under WTO law.

[13] Panel report adopted on 22 March 1988 (L/6268–35S/98).

dried, smoked, pickled, or frozen. In the event the Panel found that the parties were in agreement that the export ban was inconsistent with GATT Article XI:1; the issue before the Panel was whether the ban qualified under exceptions GATT Article XI:2(b) or Article XX(g). With respect to Article XI:2(b), the Panel concluded that the export ban was not a marketing regulation and was not necessary to maintain international quality standards. With respect to the Article XX(g) issue, the Panel ruled that the export restrictions were not maintained in conjunction with appropriate domestic processing and consumption restrictions. Thus, neither exception applied to Canada's export ban, which was contrary to GATT Article XI:1.

The *Japan—Semiconductor* case[14] involved export restrictions imposed by Japan on the export of semiconductor chips as a result of a trade agreement between Japan and the United States. This trade agreement required Japan, among other things, to maintain minimum export prices for semiconductor chips; not to engage in export sales below certain cost criteria; to monitor chip exports to third countries; and to subject chip exports to licensing procedures. Acting on a complaint by the European Communities (EC), the GATT Panel found that these export restrictions constituted violations of GATT Article XI:1, which broadly prohibits export measures other than tariffs and charges.[15]

In *Argentina—Hides and Leather*,[16] the European Communities contested Argentina's practice of allowing domestic tanners to participate in a committee associated with customs clearance procedures for bovine hides. The EC argued that this participation was a violation of GATT Article XI:1. The WTO Panel, however, rejected this argument, finding that this participation did not amount to an export prohibition. Nevertheless, the Panel ruled that Argentina's practice of allowing tanners to participate in the customs clearance procedures of bovine hides was not reasonable and so was inconsistent with GATT Article X:3(a).

Two landmark cases involved export restrictions on various natural resources adopted by China. The first case, *China—Raw Materials*, involved complaints against China by the United States, the European Union (EU), and Mexico concerning Chinese export restrictions on a variety of minerals, including forms of bauxite, coke, fluorspar, magnesium, manganese, silicon carbonate, silicon metal, yellow phosphorus, and zinc. Most of these materials are important components for the production of a wide variety of high-tech products. The complainants charged that the restrictions in question were designed to keep the cost of such materials low in China while fostering high prices in the rest of the world. Four types of export restraints were at issue: (1) export duties; (2) export quotas; (3) export licensing; and (4) minimum export price requirements. As to the export duties, the Appellate Body affirmed the Panel's determination that, although such duties are permitted under GATT Article XI:1, such duties were forbidden under paragraph 11.3 of China's Accession Protocol to the WTO. Export quotas are also

[14] Panel report, *Japan—Trade in Semiconductors*, adopted 4 May 1988 (L/6309–35S/116).

[15] For commentary see especially John Kingery, 'The US—Japan Semiconductor Arrangement and the GATT' (1989) *Stan. J. Int'l L.* 25, 467 and Amelia Porges, 'Japan—Trade in Semiconductors' (1989) *Am. J. Int'l L.* 83(2), 388.

[16] Panel report, adopted 16 February 2001.

prima facie forbidden by GATT Article XI:1. As for export licensing and minimum export pricing, the Appellate Body vacated the Panel's findings of Article XI:1 violations on the grounds that these issues were not within the Panel's terms of reference.

The most important aspect of the decision in this case was the ruling with respect to possible exceptions allowing export measures. China attempted to justify its export restrictions on the basis of GATT Article XX as well as Article XI:2(a). As to Article XX, the Appellate Body upheld the Panel's finding that the terms of China's Accession Protocol do not permit China to invoke Article XX because there is no textual link between paragraph 11.3 of the Accession Protocol and GATT Article XX.[17] In contrast, in the *China—Publications* case, the Appellate Body held that China may invoke Article XX with respect to its trading rights because of a specific reference in that part of the Accession Protocol to China's rights under the WTO Agreement.[18] Despite this ruling, the Panel took up the question of the application of GATT Article XX on an *arguendo* basis.

With respect to Article XX(g), the Panel, while affirming that China, as all countries, have sovereign rights over their natural resources, stated that the crucial question was whether China's export restrictions 'relate to' a bona fide conservation programme, and, if so, whether the export measures are made 'in conjunction with' restrictions on domestic production and consumption. The Panel answered this question in the negative, ruling that 'Article XX(g) cannot be invoked for GATT-inconsistent measures whose goal or effect is to insulate domestic producers from foreign competition in the name of conservation.'[19] To prevail under GATT Article XX(g), the Panel stated, 'In order to show even-handedness, China would need to show that the impact of the export duty or export quota on foreign users is somehow balanced with some measure imposing restrictions on domestic users and consumers'.[20] Somewhat disappointingly, the Appellate Body reversed the Panel's decision, finding that the Panel had erred in interpreting the phrase 'in conjunction with' in Article XX to require a showing that the purpose of the challenged measure must be to make effective domestic restrictions on production or consumption.[21] The Appellate Body did not comment on the rest of the Panel's ruling on this issue.

The Panel also addressed in detail the Article XX(b) defence argued by China in this case. China argued that the export restrictions were 'necessary' under Article XX(b) to protect the health of its domestic population because they reduce the pollution emitted in the course of extraction and production of these minerals. The Panel accepted this point but applied the usual balancing tests to determine if the measures in question were 'necessary'. Applying these tests, the Panel considered separately the pollution from the production of energy-intensive, highly polluting, resource-based products, on the one hand, and pollution from the production of scrap metal products. The Panel ruled, first, that the interests at stake were of vital importance,

[17] Appellate Body report, *China Raw Materials*, para. 306.
[18] Appellate Body report, *China Publications*, paras. 229–33.
[19] Panel report, para. 7.408. [20] Panel report, para. 7.465.
[21] Appellate Body report, paras. 359–60.

but, second, that the export measures in question make no mention of environmental or health concerns, concluding 'we do not discern in this array of measures a comprehensive framework aimed at addressing environmental protection and health.'[22] Third, the Panel ruled that there was no evidence that measures make a material contribution to reducing pollution. Fourth, the Panel ruled that the measures in question had a worldwide, important trade impact. Finally, the Panel stated that numerous alternatives were available to safeguard the health of the Chinese people, including investment in more environmentally friendly technologies, promotion of recycling, increasing environmental standards, investing in infrastructure necessary to recycle scrap, stimulating greater local demand for scrap, and introducing pollution controls on primary production facilities. For these reasons the Panel held that the export measures in question could not be justified under Article XX(b). Despite this comprehensive and highly persuasive holding, the Appellate Body did not consider this issue because China did not appeal this issue.

The Appellate Body did discuss in detail the exception for export measures contained in GATT Article XI:2(a), which exceptionally permits export measures temporarily applied to prevent or relieve a critical shortage of foodstuffs or some other essential product. On this issue the Appellate Body upheld the Panel, holding that China's measures did not qualify under this provision. The provision has three elements: (1) 'temporarily' qualifies 'applied' and means bridging a passing need; (2) a shortage must be 'critical' meaning 'crucial'; and (3) the products involved, although not limited to foodstuffs, must be 'essential'. Applying these tests, China's measures have lasted at least ten years and cannot be considered temporary.[23]

In 2014, a WTO Panel decided a similar case, the *China—Rare Earths* case, which involved export duties, export quotas, and export administration requirements placed by China on various forms of rare earth minerals as well as tungsten and molybdenum. In this case the Panel—one member dissenting—found no reason to depart from the Appellate Body's ruling in *China—Raw Materials*, that GATT Article XX defences are not available to qualify China's obligations under paragraph 11.3 of China's Accession Protocol.[24] The Panel also concluded that China's export quotas were inconsistent with GATT Article XI:1.[25] As for the Article XX(g) issue, the Panel ruled that China failed to establish that domestic environmental measures are capable of having a limiting impact on domestic production and consumption of the minerals at issue.[26] Concerning Article XX(b), the Panel concluded that there was no evidence that the export measures were part of a plan to control pollution.[27] The Panel also faulted China for violating the chapeau of Article XX since it found that the export measures were being applied on a discriminatory basis.[28]

[22] Panel report, paras. 7.501–7.511.
[23] Appellate Body report, paras. 322–7.
[24] Panel report, paras. 7.47–7.48.
[25] Panel report, para. 7.200.
[26] Panel report, paras. 7.556–7.666.
[27] Panel report, paras. 7.194–7.195.
[28] Panel report, paras. 7.825–7.828.

3. WTO Rules on Export Measures

3.1 WTO discipline on export measures

We begin with the major WTO disciplinary rules on export measures. GATT Article XI:1 broadly prohibits export restraints other than duties, taxes, or charges. The disciplinary rule of Article XI:1 is interpreted to prohibit quotas, including export bans and embargos,[29] minimum price requirements,[30] and burdensome export licensing and administrative requirements[31] that artificially burden exporters. Even non-legally binding government interference that impedes exports is included in the Article XI:1 prohibition.[32]

3.2 Exceptions permitting export measures

There are many exceptions to the basic prohibition of Article XI:1. Notably the following export restraints may be maintained:

1. Export duties, taxes, or charges;[33]
2. Export measures temporarily to relieve 'critical shortages' of foodstuffs and other essential products;[34]
3. Export measures necessary to the application of standards or regulations relating to the classification, grading, or marketing of commodities in international trade;[35]
4. Export measures 'necessary to protect human, animal or plant life or health';[36]
5. Export measures to restrict the exportation of gold or silver;[37]
6. Export measures to protect 'national treasures of artistic, historic, or archaeological value';[38]
7. Export measures to conserve 'exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption';[39]
8. Export measures to comply with obligations under any intergovernmental commodity agreement;[40]
9. Export restrictions necessary to ensure essential quantities of domestic materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a government stabilization plan;[41]
10. Export restrictions essential to the acquisition or distribution of products in short supply;[42] and

[29] *Canada—Unprocessed Herring and Salmon* case.
[30] *Japan—Semiconductors* case. [31] Ibid.
[32] *Japan—Semiconductors* case. [33] GATT Art. XI:1.
[34] GATT Art. XI:2(a). [35] GATT Art. XI:2(b).
[36] GATT Art. XX(b). [37] GATT Art. XX(c).
[38] GATT Art. XX(f). [39] GATT Art. XX(g).
[40] GATT Art. XX(h). [41] GATT Art. XX(i). [42] GATT Art. XX(j).

11. Export restrictions that come within the scope of GATT Article XXI: Security Exceptions.

Some of these exceptions are relatively narrow and present little problem. However, many are very broad and uncertain in application. The most important exceptions are those for export taxes, duties, and charges, the two environmental provisions, Article XX(b) and (g), and the security exception, Article XXI.

4. Export Tariffs

Export duties, taxes, and charges—export tariffs—are broadly exempted and permitted by Article XI:1. Thus, WTO members are free to impose export duties on any product as they deem appropriate—as long as they abide by the non-discrimination, MFN rule of GATT Article I:1 and the transparency rule of GATT Article X. This brings up an important question: is there authority in the GATT to negotiate and to 'bind' export duties at internationally enforceable limits? There is no authoritative answer to this question and two views have been expressed. One view, stated by Professor Jackson,[43] is that an elimination or reduction of an export duty is not a tariff concession in the sense of GATT Article II:1(b), which mentions only import tariffs, not export tariffs. On the other hand, Frieder Roessler[44] and UNCTAD[45] take the position that the elimination or reduction of an export tariff is a tariff concession in the sense of Article II:1(b) because Article II:1(a), the general provision to which Article II:1(b) refers, broadly includes 'commerce' which includes export matters as well as import matters. Thus, the GATT authorizes binding of export as well as import tariffs. Furthermore, under this view, GATT Article XXVIII as well as Article XXVIII *bis*, authorize negotiations (and resulting agreements) to bind and reduce or eliminate export tariffs. We believe the latter is the correct answer to this question. Article XXVIII *bis* in fact mentions exports as well as imports, and we believe that the intention of the parties as expressed in the language of the GATT and taking its entire context into account, is to authorize WTO members to negotiate and to 'bind' export duties. We also note that several Schedules of WTO members in force under GATT Article II establish bindings for export duties on specified products.[46] Thus, clear WTO practice is to treat export duties as well as import duties as subjects of international agreement and bindings. Export tariffs are, therefore, legal in virtually any amount if they have not been bound; but unequivocally export tariffs can be bound and increasingly are being bound by WTO parties.

Despite the specific exemption in Article XI:1 permitting export duties, taxes, and charges (export tariffs), as is evident from the *China—Raw Materials* and *China—Rare*

[43] John H. Jackson, *World Trade and the Law of the GATT* (Indianapolis: Bobbs-Merrill, 1969) 499.
[44] Frieder Roessler, 'The GATT and Access to Supplies' (1975) *Journal of World Trade* 9(12), 25–39.
[45] United Nations Conference on Trade and Development: Trade Agreements, Petroleum and Supply Policies 2 (2000).
[46] For example, Australia has agreed to refrain from imposing export duties on certain iron ore, zirconium, coal, peat, coke, refined copper, unwrought nickel, nickel oxide, and lead waste and scrap. See Julia Ya Qin, 'Reforming WTO Discipline on Export Duties: Sovereignty over Natural Resources, Economic Development and Environmental Protection' (2012) *Journal of World Trade* 46(5), 1147, 1152.

Earths cases, certain WTO members, such as China, are prohibited to some degree from imposing export tariffs by the terms of their Accession Protocol to the WTO. Not only China but also other WTO members—Mongolia, Latvia, Saudi Arabia, Montenegro, Vietnam, Ukraine, and Russia, among others—have undertaken export duty commitments in their respective Accession Protocols.[47] Under the Appellate Body decisions in the two China cases, it is evident that the WTO considers each Accession Protocol as a self-contained agreement. The scope and nature of the accession commitments on export duties vary widely. Thus the situation with regard to whether export duties are permitted under WTO rules is many-splendoured: there is not one rule but almost as many rules as there are WTO members—in order to answer this question as to a particular WTO member, three separate documents must be consulted: (1) GATT Article XI:1; (2) the particular member's Schedule under GATT Article II; and (3) if applicable, the member's particular Accession Protocol.

Another anomaly that creates confusion and chaos with respect to the rules on export tariffs is the fact that all WTO members are parties to at least one, and in most cases several free trade and/or customs union agreements. Over 200 of such agreements have been notified to the WTO.[48] Many of these free trade agreements adopt rules on export taxes and export measures that are binding between members. For example, NAFTA, which concerns Canada, Mexico, and the United States, prohibits export tariffs (Article 315) with some exceptions, such as for GATT Articles XI:2(a), XX(g), and XX(b).

Thus, the WTO law with respect to export duties is almost completely irrational and ad hoc. This state of affairs is unfair in the extreme. What is worse, there is little possibility of correcting the present irrational system because there is typically no provision for amending various Accession Protocols. And the problem is further compounded by the many exceptions to Article XI:1 that permit export measures in many situations. These exceptions are not clearly delineated so that the relevant legal rules are obscure and present many unanswered difficulties.

5. Natural Resources

As the WTO and OECD studies referenced earlier in this chapter attest, many WTO members are increasingly enacting export restrictions on natural resources. This trend is likely to continue;[49] however, the rules of the multilateral trading system may be unprepared for the issues that arise in such cases.

Export restrictions on natural resources may be enacted for many different policy reasons. Some of these reasons are as follows:

- To conserve endangered fauna and flora;
- For the purpose of initiating a programme of sustainable development of natural resources;
- To reduce domestic pollution inherent in the production or consumption of such resources;

[47] See ibid. 1155. [48] See Chapter 14.

[49] Mitsuo Matsushita, 'Export Control of Natural Resources: WTO Panel Ruling on the Chinese Export Restrictions of Natural Resources' (2011) *Trade, Law and Development* 3(2), 267, 276.

- To conserve limited supplies;
- To create competitive advantage for domestic downstream industries;
- To sanction or impede competitor nations' enterprises;
- To influence global natural resources' supplies and prices;

The *China—Raw Materials* case and the *China—Rare Earths* case are widely seen as landmark cases in what may become a plethora of future natural resources export cases. As the foregoing exposition of the WTO export rules shows, the WTO is unprepared for possible developments in this area. In this section we explore the applicable legal rules to export restrictions on natural resources and we highlight future problems and uncertainties.

First, it is evident that some WTO members—no doubt most—could enact export restrictions on natural resources in the form of export tariffs/taxes for any of the foregoing reasons. Obviously this represents a large lacuna in WTO law; not only are WTO members subject arbitrarily to differing rules for no apparent reason, but export tariffs may be legally employed even when they clearly are used for improper political and economic purposes.

Second, if a WTO member wishes to activate export measures other than export tariffs, what exemptions are available? A likely scenario in this regard is the imposition of export quotas on natural resources. What legal requirements must be fulfilled for such quotas to be consistent with WTO obligations?

5.1 Critical shortage/short supply

An export quota to alleviate domestic shortages would have to be justified under either GATT Article XI:2(a) or Article XX(j). The *China—Raw Materials* case was the first to interpret the former of these Articles and so is a valuable precedent. The Appellate Body in this case construed this exemption quite narrowly. Article XI:2(a) only applies with respect to natural resources that are shown to be essential in the sense of 'important', 'necessary', or 'indispensable' to the particular member. Furthermore, the terms 'temporary' and 'critical shortage' were considered to be closely related so that a chronic scarcity of natural resources would not be eligible for the exemption since it could not be remedied by a 'temporary' trade measure.[50] In *China—Raw Materials* the Appellate Body also ruled that the party invoking Article XI:2(a) has the burden of proof. GATT Article XX(j) is a similar provision, never interpreted by a GATT or WTO Panel, but appears to be more restrictive than Article XI:2(a). Not only is Article XX(j) subject to the strict non-discrimination provisions of the chapeau of this Article, the provision is also qualified by the condition that the trade restricting state must act consistently with the 'principle that all contracting parties are entitled to an equitable share of the international supply' of the natural resource in question.

[50] Appellate Body report, *China—Raw Materials*, paras. 324–7.

5.2 Creating competitive advantages for domestic downstream industries

A frequent reason for export restrictions on natural resources is the idea that such resources should not be exported but should be reserved to create opportunities for domestic processing industries. Thus, Indonesia, for example, restricts exports of tin in order to advantage the domestic tin processing industry.[51] A country rich in forest resources may restrict the export of raw timber to guarantee processing opportunities to domestic timber mills. Under the authority of the *Canada—Unprocessed Herring and Salmon* case, such export restrictions, if in the form of an export ban or a quota, is inconsistent with GATT Article XI:1. Article XX(i), as a general exception, allows export restrictions of domestic resources 'necessary to ensure essential quantities of such materials to a domestic processing industry', but this exemption is only available 'during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan.' This latter condition as well as the requirement of the chapeau would seem to make Article XX(i) unusable as a practical matter.

5.3 Export measures necessary to protect human, animal, or plant life, or health

A possible justification for export quotas on natural resources is the necessity to reduce environmental pollution from processing plants producing or refining or utilizing the natural resources. Thus, for example, a state may place a quota on coal exports on the grounds that such action is necessary to reduce carbon dioxide emissions into the atmosphere. In *China—Raw Materials*, China argued that the imposition of export quotas on primary metals was a component of its comprehensive environmental policy designed to safeguard the health of the Chinese people. In this regard, China argued that the export controls would increase the domestic supply of the minerals in question thus increasing the domestic supply of scrap metals and reducing the extraction of primary minerals, thereby contributing to the reduction of domestic pollution.[52] The Panel, however, rejected this argument on the basis that (1) there was no evidence of such a comprehensive environmental policy; and (2) numerous less trade-restrictive alternatives were available to reduce pollution.[53] Given these objections, it is difficult to imagine a case where export quotas on natural resources would be justified under this provision.

5.4 Export restrictions in conjunction with restrictions on domestic production and consumption

A final possible justification for export quotas on natural resources is reliance on the general exception contained in Article XX(g) for export limits in conjunction with domestic restrictions on production and consumption. This is, perhaps, the most viable

[51] See n. 5. [52] Panel report, paras. 7.470–7.471. [53] Ibid. paras. 7.511–7.566.

possible exception for natural resource quotas. But to carry this exception, the export-restricting state will have to show evenhandedness between the proportion of exports restricted and similar restrictions on domestic production and consumption. In both *China—Raw Materials* and *China—Rare Earths*, China made this argument without success.[54] As a practical matter this requirement of evenhandedness and compliance with the non-discrimination tests of the chapeau make this exception difficult to utilize.

5.5 Export measures on natural resources: a tangle of inconsistent legal rules

As can be seen from the foregoing analysis, WTO rules concerning export measures on natural resources are irrational and riddled with difficulties and unanswered questions. With respect to export tariffs and natural resources, there are almost as many rules as WTO members given the fact that the rules vary with each member's Article II Schedule, with the content of a member's Accession Protocol (if any) and the differing rules of free trade agreements to which the member is a party. With respect to export quotas and other export measures that affect natural resources, the only practical avenue of exception seems to be the GATT environmental exception, Article XX(g). But deploying this Article presents unanswered questions. For example, the 'evenhandedness' principle requires a proportional allocation of resources between the member's domestic market and foreign interests. But how is the proportional allocation to be made to satisfy WTO rules? Neither Article XX(g) nor any other provision of WTO law provides the answer to this question. By analogy to the WTO Safeguards Agreement, Article 5 and GATT Article XI:2(c), one could argue that the proportional allocation is to be made on the basis of past representative periods of trade volumes between the parties concerned. But this principle presents further difficulties: (1) what about the need for periodic review and changes in the initial allocation? (2) how is the proportional allocation to be maintained and enforced? In addition, if an allocation is enforced by private action this would amount to establishing an export and/or import cartel, which may infringe the competition law provisions of either the exporting or importing nation or both.[55]

WTO law concerning export measures and natural resources is in shambles and this situation cries out for reform. So far, however, WTO members have not even entered into serious discussion of these issues.[56]

[54] See text accompanying nn. 19–21 and 26.

[55] For detailed analysis of these issues, see Matsushita, 'Export Control of Natural Resources', n. 49 at 289–93.

[56] Many WTO members maintain export embargos or other export measures that are clearly illegal under existing law. For example, the United States embargos the export of both unrefined petroleum and natural gas. See 15 U.S.C. sec. 717(b) (natural gas); and 42 U.S.C. sec. 6201 *et seq.* (crude oil). Export of natural gas or crude oil from the United States requires a permit from the US Department of Energy. At this writing Congress is debating whether to change these rules to allow exports more freely.

6. Agricultural Commodities

A United Nations Food and Agriculture (FAO) Report[57] published in 2011 surveying 105 countries found that thirty-three countries (31 per cent) had in place one or more export restrictive measures on agricultural products.[58] The reason for these widespread export measures has been continuing high food prices and volatility of food prices across the world. This situation is expected to continue, and export measures on foodstuffs is now commonplace as many WTO members, especially developing countries, act to safeguard food supplies in the name of 'food security'.[59] The countries taking these export measures, virtually all of them WTO members, used a variety of policy instruments, including export tariffs, quotas, minimum export prices, export bans, and government-to-government sales.[60] The economic impact of these export measures was variable, but studies showed that in many cases high food prices and volatility were in fact exacerbated by government interventions and panic buying tactics.[61] The impact of export interventions on food and commodity prices drew this comment from *The Economist*:[62]

> A vicious circle of price rises, stockpiling and export bans does not make sense in the medium term for any commodity, whether cotton, onions or iron ore. It erodes confidence in supply chains and may dent overall production. Behaviour that may be rational for individual actors can cause chaos if everyone copies it.

Although two of the WTO rule exceptions allowing export measures other than tariffs—GATT Articles XI:2(a) and XX(j)—can be relied upon in appropriate cases to maintain food security, the nations adopting export restrictions on agricultural products seem to have acted in panic without regard for adhering strictly to WTO rules. Yet no challenge has been made to such actions since virtually all of the restricting states are developing countries or countries in transition. Many states rely on the provisions of Article 12 of the WTO Agreement on Agriculture (Disciplines on Export Prohibitions and Restrictions) (AoA),[63] but clearly Article 12 of this Agreement incorporates and does not replace GATT Article XI. Any WTO member adopting agricultural export restrictions must comply not only with AoA Article 12 but also with the provisions of the GATT. Despite this, in the current state of affairs, at least 528 export-restricting measures by thirty-three countries involving agricultural commodities have been taken with little regard if any for the rules of WTO law.

Discussions and negotiations among WTO members have failed to reach any agreement on the legal, political, and economic issues involved in this matter.[64]

[57] Ramesh Sharma, 'Food Export Restrictions: Review of the 2007–2010 Experience and Considerations for Disciplining Restrictive Measures' (FAO Commodity and Trade Policy Research Working Paper No. 32, May 2011).

[58] Ibid. 3. [59] Ibid. 7. [60] Ibid. 9.

[61] Ibid. 17. See also Anderson et al., 'Export Restrictions and Food Market Instability' (9 November 2010) *VoxEU.org*.

[62] *The Economist*, 10 March 2012, 78.

[63] See Thomas Schoenbaum, 'Fashioning a New Regime for Agricultural Trade: New Issues and the Global Food Crisis' (2011) *J. Int'l Econ. L.* 14(3), 593.

[64] Agricultural Negotiations Backgrounder, available at <http://www.wto.org>.

We think the best solution is to forbid all export-restrictive measures on agricultural commodities except export tariffs. This 'tariffication' solution would allow all states to freely adopt export restrictions that they believe to be in their national interests, but would allow imports (albeit paying the tax) and would allow further negotiations to reduce or bind the export tariffs in question.

7. Security Exceptions

Certain WTO members have created voluntary associations for the purpose of coordinating export controls for security reasons. Four such groups are especially important: (1) the Wassenaar Arrangement, with forty-one states parties, places export controls on eight categories of weapons systems and nine categories of dual use technologies; (2) the Missile Technology Control Group, which consists of thirty-four states, enforces export controls on missile technologies capable of delivering weapons of mass destruction; (3) the Australia Group of forty-eight countries enforces export controls on technologies and materials used to manufacture chemical and biological weapons; and (4) the Nuclear Suppliers Group (forty-six nations) exercises export controls over nuclear materials and technologies. Developed countries, including the United States, maintain extensive export control regimes for the purpose of enhancing security.[65]

The United States is the leading proponent of export sanctions to accomplish foreign policy objectives.[66] Although economic sanctions have a poor track record,[67] the United States maintains sanctions against many countries: at the time of writing thirty nations are subject to US economic sanctions.[68]

7.1 GATT Article XXI

GATT Article XXI contains 'security exceptions' to the GATT rules that particularly affect export restraints.[69] The GATS Article XIV*bis*[70] contains very similar security provisions. Article XXI reads as follows:

> Security Exceptions
> Nothing in this Agreement shall be construed

[65] The United States is in the midst of enacting a series of reforms designed to streamline its export control regime. See Overview of US Export Control System, available at <http://www.state.gov/strategictrade/overview>.

[66] For details, see John W. Boscariol et al., 'Export Controls and Economic Sanctions' (2010) *International Lawyer* 25.

[67] See Gary Clyde Hufbauer et al., *Economic Sanctions Reconsidered: Historical and Current Policy* (Washington, DC: Institute for International Economics, 1990) (concluding that such sanctions failed to achieve their objective in 66 per cent of cases).

[68] A list of sanctioned countries may be found at <http://www.mondaq.com>.

[69] For a comprehensive review of Art. XXI, see Michael J. Hahn, 'Vital Interests and the Law of GATT: An Analysis of GATT's Security Exception' (1991) *Mich. J. Int'l L.* 12, 558.

[70] The GATS also contains in an Annex on the Movement of Natural Persons Supplying Services Under the Agreement, that may be invoked in a case of security concern.

(a) to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or

(b) to prevent any contracting party from taking action which it considers necessary for the protection of its essential security interests

(i) relating to fissionable materials or the materials from which they are derived;

(ii) relating to the traffic in arms, ammunition or implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;

(iii) taken in time of war or other emergency in international relations; or

(c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

Article XXI has been invoked several times, but there is no definitive interpretation of its scope. The first invocation of Article XXI set the tone of the debate. In 1949, the United States cited Article XXI to justify export restraints against Czechoslovakia. The United States took the position that this Article could be invoked unilaterally as a carte blanche exception. The representative of Czechoslovakia disagreed, arguing that Article XXI should be interpreted closely. The GATT contracting parties rejected the Czechoslovakian complaint,[71] and the UK delegate expanded the US position that 'since the question clearly concerned Article XXI, the United States action would seem to be justified because every county must have the last resort relating to its own security'.[72]

Subsequently, Article XXI was invoked by Ghana to restrict its trade with Portugal,[73] by the United States to boycott trade with Cuba,[74] by the European Community to restrict trade with Argentina during the Falklands/Malvinas War,[75] by Germany against Iceland,[76] by the United States against Nicaragua,[77] and by Sweden to justify import quotas for certain footwear.[78]

Because Article XXI has never been definitively interpreted, the issue presented is whether the subsections of the Article have objective content or present open-ended exceptions that can be invoked unilaterally. This question should properly be asked with respect to each of the subsections of the Article.

Article XXI(a), first of all, is worded very broadly and appears to be an open-ended exception. The only criterion is whether the state concerned 'considers' the disclosure of information contrary to its essential security interests. This is obviously a subjective judgement. The scope of Article XXI(a) is limited, however. It cannot be invoked to justify export restraints but merely to withhold information.

[71] GATT B.I.S.D. (2d Supp.) at 28 (1952). [72] Ibid.

[73] GATT B.I.S.D. (5th Supp.) at 196 (1961).

[74] GATT Doc. Com. Ind/G Add.4 (12 December 1968).

[75] GATT Council, Minutes of Meeting Held on 7 May 1982, GATT Doc. C/B/157 (22 June 1982).

[76] GATT Council, GATT Doc. C/B/103 (18 February 1975).

[77] *US—Trade Measures Affecting Nicaragua*, 15 July 1985, GATT Doc. L/5847 (1985).

[78] *Sweden—Import Restrictions on Certain Footwear*, 19 November 1975, GATT Doc. L/4250 (1975).

On the other hand, Article XXI(b) is worded in both a subjective and objective manner. Subjectively, a WTO member must consider action 'necessary' for the protection of its essential security interests. But the three subsections of the Article define objective circumstances. Article XXI(b)(i) requires the matter to relate to fissionable materials or the materials from which they are derived. This subsection is quite clear and uncontroversial. The export of fissionable materials or uranium may be banned, whether for civilian or military purposes. This subsection is rooted in preventing nuclear proliferation and protecting health and safety. Article XX(b)(ii) refers not only to 'other goods and materials . . . directly or indirectly for the purpose of supplying a military establishment'. This certainly would include so-called 'dual use' goods, those such as sophisticated computers and technology suitable for both civilian and military use; but the Article does not define its scope. Thus as a practical matter, export controls in arms and 'dual use' goods are left up to the discretion of each WTO member.

Article XXI(b)(iii) is the most controversial subsection of this provision. It authorizes economic measures in two instances: in time of war or 'other emergency in international relations'. The first term, 'war', should be considered to have objective content; war is a term of general international law and international relations and should be defined as such. War includes not only declared war, but also any situation involving armed conflict. War is a state of objective conditions that may cover legal as well as illegal use of arms. Export controls are justified in this situation.

A more difficult problem is posed by the term 'other emergency in international relations'. This obviously is broader than 'war'; it also is *not* a term of art in public international law. Two major issues are presented in the interpretation of this term: (1) whether this is a self-judging provision in the discretion of the state that invokes it; and (2) whether the phrase has an objective content.

Some authors have concluded that Article XXI is a self-judging provision,[79] but this view seems untenable. The GATT rules are not designed to be self-judging, and unilateral action is specifically excluded in the Dispute Settlement Understanding (DSU). If any part of Article XXI were intended to be self-judging, the parties to the GATT or WTO would have specified this. The vague and ambiguous wording of parts of Article XXI(b), including the 'emergency' provision, may constitute a loophole in the GATT,[80] but this does not mean that it is self-judging. In fact, the legislative history of the provision indicates the Article was not to be excluded from GATT dispute settlement procedures,[81] so that it was not conceived of as a self-judging provision.

Despite its ambiguity, the phrase 'emergency in international relations' has a certain objective content. The term 'emergency' requires a certain degree of seriousness as distinguished from routine tensions or disagreements. The phrase certainly would apply to international situations that could pose a threat of future, armed conflict.

[79] For example, Richard Sutherland Whitt, 'The Politics of Procedure: An Examination of the GATT Dispute Settlement Panel and the Article XXI Defense in the Context of the U.S. Embargo of Nicaragua' (1987) *Law & Pol'y Int'l Bus.* 19, 604, 616. This was the US position with respect to the Helms-Burton Act and similar legislation. See Hannes L. Schbennan and Stefan Ohlhoff, 'Comment' (1999) *Am. J. Int'l L.* 93, 424.

[80] See Jackson, *World Trade and the Law of GATT* (1969), n. 43 at 748.

[81] See Hahn, 'Vital Interests and the Law of GATT', n. 69 at 556–67.

But clearly 'emergency' can refer to an economic, social, or political situation as well. The best reading of this phrase would seem to allow it to apply to almost any situation, but to confine it to those of a serious nature. This implies a case-by-case judgment by WTO dispute settlement Panels.[82]

Only two GATT Panel reports have dealt with Article XXI issues; both involved the United States and Nicaragua. In the first case,[83] the United States unilaterally reduced its import quota for Nicaraguan sugar. Although the US action was in retaliation for the Nicaraguan government's support of subversive activities in the region and its military build-up, the United States did not invoke Article XXI as a defence. Instead, the United States took the position that it was 'neither invoking any exception under . . . the General Agreement nor intending to defend its actions in GATT terms'.[84] The United States maintained that its dispute with Nicaragua was outside the ambit of the GATT. The Panel did not analyse whether the reduction in Nicaragua's quota was justified under Article XXI.[85] In the second GATT case,[86] the terms of reference stated that Article XXI(b)(iii) was not within the ambit of the Panel's examination. Thus, the Panel concluded that 'it could find the United States neither to be complying with its obligations under the [GATT] nor to be failing to carry out its obligations . . . '.[87]

It is unfortunate that the United States in the two Nicaragua cases was not willing to invoke Article XXI(b)(iii).[88] The argument exists that the US action restricting trade was a countermeasure under international law in response to a breach of the law by Nicaragua. Article XXI(b)(iii) should be interpreted to support trade measures enacted as countermeasures that are proportioned to an illegal act committed by the target state and are designed to secure compliance with international legal norms.[89]

Article XXI(c) ties the GATT to the UN Charter by providing that a WTO member may take any action to fulfil its obligations under the Charter. This would permit trade sanctions authorized by the UN Security Council under Chapter VII of the Charter to maintain international peace and security.

7.2 Extraterritorial application of export controls

A frequently occurring issue with respect to US export controls is the extent to which legislation passed by the US Congress can be made binding upon non-US companies and persons operating outside US territory. This issue first arose in 1982 when the United States imposed export controls on oil and gas equipment destined for the Soviet

[82] In 1996, the EC brought a claim against the United States over the application of US trade sanctions against Cuba. *US—The Cuban Liberty and Democratic Solidarity Act*, WT/DS38. This case was suspended on 22 April 1998 without a decision.

[83] *US—Import of Sugar from Nicaragua*, 13 March 1984, GATT B.I.S.D. (31st Supp.) at 67 (1984).

[84] Ibid. at 72, para. 3.10.

[85] Ibid. at 74, para. 4.4.

[86] Panel report, *US—Trade Measures Affecting Nicaragua*, 13 October 1986, GATT Doc. L/6053 (1986).

[87] Ibid. 14.

[88] For analysis of the meaning of the term 'international emergency', see Sarah H. Cleveland, 'Human Rights Sanctions and International Trade: A Theory of Compatibility' (2002) *J. of Int'l Econ. L.* 5, 133, 183–6.

[89] See Hahn, 'Vital Interests and the Law of GATT', n. 69 at 603.

Union to protest that country's repression of the Solidarity labour movement in Poland. US export controls purported to regulate not only exports by US persons but also exports by foreign subsidiaries of US persons.

The extraterritorial regulation of exports should be structured so as not to contravene fundamental principles of international law relating to jurisdiction. In international law, prescriptive jurisdiction must be based upon certain recognized criteria to avoid conflicts with other states. These generally are:

1. *The territoriality principle*. A state may pass laws governing people and property in its own territory.
2. *The nationality principle*. A state may regulate its citizens in any part of the world.
3. *The objective territoriality principle*. A state may regulate conduct that has a direct and substantial effect within its territory even though the acts giving rise to the effects are undertaken abroad.
4. *The passive personality principle*. A state may prescribe conduct directed against the welfare of its own citizens.
5. *The protective principle*. A state may regulate conduct that targets its national security.
6. *The universality principle*. All states may exercise jurisdiction over certain criminal activity, notably piracy and slavery.

Although never tested in the WTO or by any international tribunal, it is doubtful at best that US legislation extending to the activities outside US territory of foreign subsidiaries of US companies is consistent with any of the norms listed above.

Neither the territoriality nor the nationality principle apply in most extraterritorial cases since, under international law, a 'state may not ordinarily regulate the activities of corporations organized under the laws of a foreign state on the basis that they are owned or controlled by nationals of the regulating state'.[90] In some extraterritorial cases foreign courts have contested US regulation on this basis: in *Freuhauf Corp. v Massardy*,[91] the French Court of Appeal ordered the appointment of a short-term administrator in order to avoid the directive of a US parent corporation to comply with US export controls.

But we believe that extraterritorial application of many export control measures may be justified under the protective and passive personality principles of international jurisdictional law. Clearly export controls related to weapons and international security are within the scope of the protective and passive personality principles. We believe these two principles are implicit in the security provision of the GATT.

It is an open question at the WTO, however, how far to take these two principles as justification for a WTO member's foreign policy economic sanction measures. Cases in point: the US Cuban Liberty and Democratic Solidarity Act of 1996[92] and the Iran and

[90] Restatement (Third) of the Foreign Relations Law of the United States (1987), § 4114(2).
[91] *Fruehauf Corp. v Massardy* (1996) 5 I.L.M. 476.
[92] Cuban Liberty and Democratic Solidarity Act of 1996, 22 U.S.C.A. § 6021 *et seq.*, reprinted in (1996) 35 I.L.M. 367.

Libya Sanctions Act of 1996.[93] The Cuban Act strengthens the enforcement of the US economic embargo against Cuba by creating a cause of action in US federal courts in favour of any person whose property was nationalized by the Cuban government against any person guilty of 'trafficking in the confiscated property'; trafficking is defined very broadly to include virtually any transaction or commercial benefit involving the property. The Cuban Act also excludes all traffickers and their relations from entering the United States. The Iran–Libya Sanctions Act requires economic sanctions against any foreign company that invests substantial sums for energy development in Iran or Libya.

We believe GATT Article XXI(b)(iii) serves to justify these Acts, although the case seems to be clearer with regard to the latter and more doubtful with regard to the former Act. We do not believe, however, that a WTO Panel or the Appellate Body should seek to overrule a member's judgement on what is an emergency in international relations except in the most obvious circumstances. Governments must be free to protect what they consider their vital interests. This includes law enforcement measures that may have some extraterritorial impact.[94] The WTO, however, has not rendered a definitive ruling on these issues. The European Community challenged both acts in 1996, but both disputes were settled by agreement in May 1998.[95]

8. Preferential Trade Agreements and Export Restrictions

While the WTO rules concerning export restrictions are impossibly ambiguous and incomplete, export restrictions are treated much more comprehensively and definitively in many bilateral and multilateral preferential trade agreements (PTAs). For example, NAFTA Article 314 prohibits any party from maintaining any tax, duty, or other charge on exports, unless the tax, duty, or charge is maintained on exports of any such good to the territory of all other parties; and such tax, duty, or charge applies to such good when destined for domestic consumption. NAFTA Article 604 prohibits export charges on energy supplies or products. NAFTA Article 315 specifies the conditions for the application of GATT Articles XI:2(a), and XX(g), (i), and (j). Under NAFTA Canada benefits from exemptions for export restrictions in the form of quotas on the export of unprocessed fish and log species. While it is beyond the scope of this chapter to detail and analyse the many PTAs and their provisions on export rules, we believe that almost all contain such rules and that, because the confusing and incomplete rules of the WTO are not likely to be changed, PTAs are the best vehicles to address and develop needed export control disciplines.

[93] Iran and Libya Sanctions Act of 1996, 50 U.S.C.A. § 1701, reprinted in (1996) 35 I.L.M. 1273.

[94] See Steve Charnovitz, 'The World Trade Organization and Law Enforcement', Paper Prepared for a Round Table of the Council on Foreign Relations, 6 March 2003, available at <http://www.cfr.org/world/world-trade-organization-on-law-enforcement/p5860>.

[95] See 'Current Developments' (1999) *Am. J. Int'l L.* 93, 227.

9. Conclusions

The WTO/GATT regime regulatory export controls generally prohibit restraints while permitting export taxes. There are exceptions for many types of export controls for environmental purposes, to protect national security and for bona fide economic reasons. There are many unanswered legal questions involving the compliance of export controls with GATT/WTO norms. Most PTAs address export restrictions under the aegis of 'GATT Plus'. Because the rules concerning exports are not likely to be reformed or updated, we agree with commentators who point out that future export rules should be addressed in bilateral and multilateral preferential trade agreements.[96]

[96] See Stormy-Annika Mildner and Gitta Lauster, 'Settling Trade Disputes over Natural Resources: Limitations of International Trade Law to Tackle Export Restrictions' (2011) *Goettingen J. of Int'l L.* 3(1), 251.

16

Trade in Services

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1. Introduction to the GATS and Trade in Services

The General Agreement on Trade in Services (GATS) is the first *comprehensive* multilateral agreement on trade in services; not least due to its existence, 'services' have become an indispensable part of any trade deal, both at the WTO level and in the FTA arena.[1]

[1] cf., for example, chapter seven of the Free Trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part, [2011] *OJ* L 127; Title IV of the Trade Agreement between the European Union and its Member States, of the one part, and Columbia and Peru, of the other part, [2012] *OJ* L 354/1; and the services chapters in the Canada–EU Trade Agreement (CETA).

The GATS is inspired by the structure of the GATT, but displays many important elements of its own. Services are usually heavily regulated at the domestic level, reflecting the importance of many service sectors for the well-being of states and societies. Indeed, at the time of writing, the world is reeling from the consequences of major problems in one of the most important service sectors: the financial industry. Also, services tend to be politically more sensitive than goods, due to questions such as: Who should be entitled to perform heart surgery on your mother? Who may have access to the legal profession in your country and represent your interests during a divorce?

Before the Uruguay Round, very few trade agreements even addressed trade in services, the most notable exception being the EC Treaty.[2] However, cross-border trade in services grew exponentially since the various 'big bangs' in the last quarter of the twentieth century, which mostly liberalized specific service industries, for instance the financial industry, telecoms, broadcasting, but also regulatory regimes governing legal services, accounting, and other liberal professions. This sudden liberalization of market forces went hand in hand with significant commercial and technological changes: the advent of the internet and other forms of reliable and powerful data transfers reduced the previously insurmountable 'proximity burden'; global value chains have become a reality.[3] These developments allowed the expansion of a global transport, logistics, and telecommunications infrastructure that, once established, attracts and creates new demand. Finally, the ever increasing wealth of OECD consumers and the development of significant wealth in Asia, South America, and, since the beginning of this century, in many parts of sub-Saharan Africa contributed to the growth in services trade, for example in the areas of tourism, transport, telecom banking, and audio-visual services.

As a consequence of these developments, services represent around two-thirds of global GNP; the service industry also accounts for two-thirds of all FDI.[4] Nevertheless, the value of trade in services amounts to only 20 to 25 per cent of trade in goods.[5] Services, it seems, still travel less well than goods.

While OECD countries remain the biggest service exporters, trade statistics show a significant growth of services export from developing countries.[6] This, of course, also highlights the importance of services and the service industry for overall economic

[2] In the 1980s, the Australia–New Zealand Closer Economic Relations Trade Agreement, the US–Israel Free Trade Agreement, and the US–Canada Free Trade Agreement also addressed services.

[3] cf. Patrick Low, 'The Role of Services' in Deborah K. Elms and Patrick Low, eds., *Global Value Chains in a Changing World* (WTO Publications, 2013) 61–81.

[4] OECD, WTO, UNCTAD (eds), *Implications of Global Value Chains for Trade, Investment, Development and Jobs*, 6 August 2013, Prepared for the G-20 Leaders Summit Saint Petersburg (Russian Federation) September 2013.

[5] See WTO Secretariat, *International Trade Statistics 2014*, available at <http://www.wto.org/english/res_e/statis_e/its2014_e/its14_toc_e.htm>; see also Pierre Sauvé and Robert Stern, eds., *The GATS 2000, New Directions in Services Trade Liberalization* (Brookings, 2000); Patrick Messerlin, *Measuring the Cost of Protectionism in Europe* (Washington DC: Institute for International Economics, 2001) 200; Eric Leroux, 'Eleven Years of GATS Case Law: What Have We Learned?' (2007) *J. of Int'l Econ. L.* 10, 749–93.

[6] In areas such as audio-visual services, cultural services, professional services, and computer services, countries such as Argentina, Brazil, China, Egypt, Hong Kong, India, Israel, Mauritius, Mexico, Singapore, South Africa, Thailand, Venezuela, and others are extremely successful; cf. WTO Secretariat, International Trade Statistics 2014.

efficiency. Without, for instance, working information and communication services, financial services, transport and logistics, and energy-related services, economic growth is difficult to achieve, and economic growth has been a characteristic not only in the usual hotspots of Asia, but also in Africa and South America. Note that in the context of 'global value chains', manufacturing processes have been separated from each other, in order to obtain for every part of the production the best quality at the best possible price. In turn, key service functions that used to be provided for in-house by manufacturers—such as design services, accounting, or after-sales services—will be outsourced, sometimes on a cross-border basis.

The argument is sometimes made that the GATS framework did not generate any additional liberalization to that which existed pre-Uruguay Round. In fairness, the GATS mostly consolidated the pre-1994 status quo,[7] which, however, had in many cases undergone significant, sometimes revolutionary, liberalization during the Uruguay Round (1986–93).[8] Irrespective of the shortcomings of the current approach, the Uruguay Round negotiations created a framework for future negotiations and represents an important decision to open up trade in this field. Finally, the *institutional* dimension of liberalization under the GATS should not be disregarded.

Substantive GATS disciplines fall into two different categories, the so-called *general obligations*, which are applicable to all WTO members, and *specific commitments*, which only exist as a consequence of specifically accepting trade liberalizing limitations of a state's right to restrict market access.

1. The 'General Obligations and Disciplines' of GATS are regulated in its Part II and include, most importantly, a general most favoured nation (MFN) obligation, but also 'good trade governance' obligations such as basic rules on domestic regulations or transparency. Some of the 'general obligations' are tied to the liberalization commitments, that is, they become binding on WTO members only for the sectors where liberalization commitments have been made, thereby adding to the complexity of the GATS.[9] In the same vein, the most central 'general obligation' reveals itself as being highly differentiated, due to the much used one-off possibility for all new members to grandfather existing preferential treatments by inscribing them into a list of MFN exemptions, pursuant to GATS Article II.2.[10]
2. The 'specific commitments' regarding market access, national treatment (NT), and 'others' are a consequence of the political will of members *not* to extend mechanically the well-established ground rules on international trade in *goods*—

[7] Compare Bernard Hoekman, 'Assessing the General Agreement on Trade in Services' in Will Martin and L. Alan Winters, eds., *The Uruguay Round and Developing Economies* (Cambridge University Press, 1996) and Sauvé and Stern, eds., *The GATS 2000* (2000), n. 5.

[8] cf. Lawrence White, 'International Trade in Services: More Than Meets the Eye' in Kwan Choi and James Hartigan, eds., *Handbook of International Trade*, vol. II (Blackwell, 2005) 472–98; Tony Warren and Christopher Findlay, 'Measuring Impediments to Trade in Services' in Sauvé and Stern, eds., *The GATS 2000* (2000), n. 5 at 57–84; Patrick Low and Aaditya Mattoo, 'Is There a Better Way? Alternative Approaches to Liberalization under GATS' in Sauvé and Stern, eds., *The GATS 2000* (2000), n. 5 at 449–72.

[9] Cases in point are GATS Arts. III, VI, VIII, and XI.

[10] GATS Art. II:2 reads: 'A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.'

where national treatment and market access are guaranteed as a matter of principle—to services. That would have required additional changes to their domestic regulatory regimes of services which had already undergone significant deregulation during the 1980s. Thus, market access, national treatment, and further trading privileges are mere options for WTO members, tools at the disposal of the membership, and exercised individually and differently by each member. Having said that, members who undertake a specific commitment are legally obliged to keep their promise, much like they are bound to honour a scheduled tariff rate pursuant to GATT 1994 Article II.

In principle, *all* services are covered by the GATS, regardless of whether they constitute the end product (the live performance of the 'Rolling Stones' at a concert) or rather an element in the production of a good (the recording of songs by the 'Rolling Stones' for a special CD, celebrating Mick Jagger's seventy-fifth birthday). In fact, a significant portion of production costs of goods may be due to services: Without the input of fashion designers, winemakers, or banana ripeners to the final products, goods such as *prêt-à-porter* fashion, wine, or bananas are impossible to produce (in the desired quality). Services, however, are not only a key input into the production of many goods.[11] They are also an input in the production of other services: the marketing (a service) of professional accounting software will not be possible without being able to highlight the high quality after-sales support, another service. And the products will of course not reach the client without transportation (or telecom) services of various kinds.

Only two categories of services are exempted from the reach of the GATS. By virtue of its Article I:3(b), the GATS is, first, not applicable to services 'supplied in the exercise of governmental authority', which are defined in GATS Article I:3(c) as 'any service which is supplied neither on a commercial basis nor in competition with one or more service suppliers'. This is a variable standard: whereas certain members will have a broader *service public*, others will only attribute core government functions, such as military defence, courts, police, and similar governmental functions, to that domain.[12]

By virtue of paragraph 2 of the Annex on Air Transport Services (which is, pursuant to GATS Article XXIX, an integral part of the GATS) the Agreement does not apply to air traffic (traffic rights and services directly related to the exercise of traffic rights). However, auxiliary services 'in the periphery' of air traffic, such as aircraft repair and maintenance services, marketing and computer reservation system services are covered by the GATS.

[11] cf. Lucian Cernat and Zornitsa Kutlina-Dimitrova, 'Thinking in a Box: A "Mode 5" Approach to Service Trade' (2014) *Journal of World Trade* 48(6), 1109–26.

[12] cf. Juan Marchetti and Petros Mavroidis, *Walking The Tightrope between Domestic Policy and Globalization: Market Access, Discrimination and Regulatory Intervention under the GATS* (Mimeo, 2006); Rolf Adlung, 'Public Services and the GATS' (2006) *Journal of International Economic Law* 9(2), 455–85; Parashar Kulkarni, 'Impact of the GATS on Basic Social Services Redux' (2009) *Journal of World Trade* 43(2), 247–8; Markus Krajewski, 'Public Services and Trade Liberalization: Mapping the Legal Framework' (2003) *Journal of International Economic Law* 6, 341; Rudolf Adlung, 'Public Services and the GATS' (2006) *Journal of International Economic Law* 9, 455; Eric H. Leroux, 'What Is a "Service Supplied in the Exercise of Governmental Authority" under Article I:3(b) and (c) of the General Agreement on Trade in Services?' (2006) *Journal of World Trade* 40, 345.

Due to time restraints, negotiations on telecommunications, financial services, and maritime transport were not concluded during the Uruguay Round and this led to Annexes being attached later.[13] The GATS, echoing the GATT tradition in this respect, reflects the expectation of the drafters that trade in services would be liberalized incrementally and progressively. Pursuant to GATS Article XIX, members shall enter into successive rounds of negotiations, beginning not later than five years from the date of entry into force of the WTO Agreement, in order to advance the objectives of the GATS.[14]

2. The Relationship between the GATT and the GATS

The GATT and the GATS were neither negotiated nor concluded simultaneously. As a result, negotiators did not pay particular attention to the issue of overlap between these two instruments. The Appellate Body dealt with this issue for the first time in its report on *Canada—Periodicals*, where it expressed the view that

> [t]he ordinary meaning of the texts of GATT 1994 and GATS as well as Article II:2 of the WTO Agreement, taken together, indicate that obligations under GATT 1994 and GATS can co-exist and that one does not override the other.[15]

The same issue came up almost simultaneously in *EC—Bananas III*, where the European Community took the position that the GATT and the GATS were mutually exclusive. The Panel disagreed because, in its view, in the absence of such a parallel application, a WTO member would too easily be able to circumvent its WTO obligations:

> [A] measure in the transport sector regulating the transportation of merchandise in the territory of a Member could subject imported products to less favourable transportation conditions compared to those applicable to like domestic products. Such a measure would adversely affect the competitive position of imported products in a manner which would not be consistent with that Member's obligation to provide national treatment to such products. If the scope of GATT and GATS were interpreted to be mutually exclusive, that Member could escape its national treatment obligation and the Members whose products have been discriminated against would have no possibility of legal recourse on account that the measure regulates "services" and not goods.[16]

The Appellate Body agreed:

> [M]easures that involve a service relating to a particular good or service supplied in conjunction with a particular good . . . could be scrutinized under both the GATT 1994 and the GATS. However, . . . the specific aspects of that measure examined under each

[13] cf. Jimmie V. Reyna, 'Services' in Terence P. Stewart, ed., *The Uruguay-Round, A Negotiating History (1986–1992)*, Volume II, 2335–425.

[14] cf. WTO Doc. S/L/92, Trade in Services, Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), adopted by the Council for Trade in Services on 23 March 2001, 28 March 2001.

[15] *Canada—Periodicals* (Appellate Body), 19.

[16] *EC—Bananas III* (Panel), para. 7.283.

agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis.[17]

3. The Scope of the GATS: Liberalization of Trade in Services

The scope of the GATS is defined in its Article I:1, according to which the GATS applies to 'measures by Members affecting trade in services'. Each of these normative prerequisites shall be discussed in the following.

3.1 Definition of 'service'

'Services' are typically described as intangible, invisible, and non-durable (or transitory) products of commercial value, requiring simultaneous production and consumption.[18] For classroom purposes, both the invisibility[19] and the fact that a service is not an intellectual property (IP) right and will not drop on one's foot are regularly emphasized. However, neither of these criteria is always fully evident: The blueprint of a microchip designer, or the plan of an architect are very visible; also executing these plans may take many years, rendering the criterion 'transitory nature' somewhat less than evident.

The closest the GATS comes to a definition of services is in Article I:3(b), where it states that 'services' includes any 'service in any sector except services supplied in the exercise of governmental authority'.[20] According to the Appellate Body,

> the structure of the GATS necessarily implies two things. First, because the GATS covers *all* services except those supplied in the exercise of governmental authority, it follows that a Member may schedule a specific commitment in respect of *any* service. Secondly, because a Member's obligations regarding a particular service depend on the specific commitments that it has made with respect to the sector or subsector within which that service falls, a specific service cannot fall within two different sectors or subsectors. In other words, the sectors and subsectors in a Member's Schedule must be mutually exclusive [emphasis in the original].[21]

[17] *EC—Bananas III* (Appellate Body), para. 221.

[18] cf. Diana Zacharias, 'Art. I GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law: WTO—Trade in Services*, Vol. 6 (Martinus Nijhoff, 2008) 38 *et seq*; Brian Copeland and Aaditya Mattoo, 'The Basic Economics of Services Trade' in A. Mattoo, R. Stern, and G. Zannini, eds., *A Handbook of International Trade in Services* (Oxford University Press) 85.

[19] 'British Invisibles' used to be the name of an industry association representing the interest of the UK financial industry, cf. now <http://www.thecityuk.com>.

[20] Art. I:3(c) defines that 'a service supplied in the exercise of governmental authority means any service which is supplied neither on a commercial basis nor in competition'.

[21] *US—Gambling* (Appellate Body), para. 180 (footnote omitted).

In *US—Gambling*, the Appellate Body decided that the Sectoral Classification List and the 1993 Guidelines were 'supplementary means of interpretation' pursuant to Article 32(a) of the Vienna Convention on the Law of Treaties (VCLT), rejecting the Panel's view that they were 'context' of GATS schedules, according to VCLT Article 31:2(a). Indeed, the Services Sectoral Classification List[22] and the Secretariat's 1993 Scheduling Guidelines[23] have been used by negotiators 'as a general benchmark or default model'.[24] Schedules drafted prior to a 2001 revision by the Council for Trade in Services (CTS)[25] should be understood as drafted according to these documents. They categorize the product 'services' in twelve sectors:[26] (1) Business services, (2) Communication services, (3) Construction and related engineering services, (4) Distribution services, (5) Educational services, (6) Environmental services, (7) Financial services, (8) Health related and social services, (9) Tourism and Travel Related services, (10) Recreational, cultural, and sporting services, (11) Transport services, and finally (12) Other services not included elsewhere. The Services Sectoral Classification List follows the United Nations Central Product Classification (UN CPC).[27] Although most WTO members have adopted it as the basis for scheduling their commitments, the use of the Services Sectoral Classification List is completely voluntary; in many ways, it serves a comparable role as the Harmonized System (HS) with regard to the GATT. If a member wishes to use its own sub-sectoral classification or definitions, it should provide concordance with the CPC.[28] If this is not possible, it should give sufficiently detailed information to avoid any ambiguity as to the scope of the commitment.

[22] GATT Doc. MTN.GNS/W/12, Services Sectoral Classification List, Note by the Secretariat, 10 July 1991.

[23] GATT Doc. MTN.GNS/W/164, Scheduling of Initial Commitments in Trade in Services: Explanatory Note, Group of Negotiations on Services, 3 September 1993.

[24] Leroux, 'Eleven Years of GATS Case Law', n. 5 at 749–93.

[25] After entry into force of the GATS, the CTS adopted on 23 March 2001 the 2001 Scheduling Guidelines (WTO Doc. S/L/92, Trade in Services, Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), adopted by the Council for Trade in Services on 23 March 2001, 28 March 2001) (hereinafter: 2001 Scheduling Guidelines), reviewing and modifying the aforementioned documents.

[26] GATS Art. XXVIII(e) defines 'sector' as: '(i) with reference to a specific commitment, one or more, or all subsectors of that service, as specified in a member's schedule; (ii) otherwise, the whole of that service sector, including all of its subsectors'.

[27] Introductory Note to the CPC, para. 31 explains the classification in the CPC system: 'The coding system of CPC is hierarchical and purely decimal. The classification consists of sections (identified by the first digit), divisions (identified by the first and second digits), groups (identified by the first three digits), classes (identified by the first four digits) and sub-classes (identified by all five digits, taken together). The codes for the sections range from 0 through 9 and each section may be divided into nine divisions. At the third digit of the code each division may, in turn, be divided into nine groups which then may be further divided into nine classes and then again into nine sub-classes. In theory, this allows for 65,610 categories. In practice however, there are 10 sections, 69 divisions, 293 groups, 1,050 classes and 1,811 sub-classes. The code numbers in CPC consist of five digits without separation of any kind between digits.'

Commitments are made at 2, 3, 4, and 5 digit levels. In contrast to the goods regime, however, WTO members can disaggregate or carve out definitions at any digit level. For instance, if a WTO member wishes to enter a commitment at the 3-digit level, but on a narrower basis than that reflected in the CPC, it can simply state so in its schedule of commitments (usually, by introducing an asterisk in the category where it wishes to make its narrower commitment).

[28] 2001 Scheduling Guidelines, n. 25, para. 24.

3.2 Definition of trade in services (modes of supply)

Pursuant to GATS Article I:2, trade in services is defined as the supply of a service:

(a) from the territory of one member into the territory of any other member;[29]
(b) in the territory of one member to the service consumer of any other member;[30]
(c) by a service supplier of one member, through commercial presence in the territory of any other member;[31]
(d) by a service supplier of one member, through presence of natural persons of a member in the territory of any other member.[32]

Note that 'supply of a service' includes the production, distribution, marketing, sale, and delivery of a service (GATS Article XXVIII(b)). The 2001 Scheduling Guidelines[33] describe the four modes of supply as follows:

Table 16.1 Modes of Supply

Supplier Presence	Other Criteria	Mode
Service supplier *not present* within the territory of the Member	Service delivered *within* the territory of the Member, from the territory of another Member	CROSS-BORDER SUPPLY
	Service delivered *outside* the territory of the Member, in the territory of another Member, to a service consumer of the Member	CONSUMPTION ABROAD
Service supplier *present* within the territory of the Member	Service delivered within the territory of the Member, through the commercial presence of the supplier	COMMERCIAL PRESENCE
	Service delivered within the territory of the Member, with supplier present as a *natural* person	PRESENCE OF NATURAL PERSON

It seems that the drafters wanted to capture all forms of trade in services relevant at the time of the negotiations and the foreseeable future.

[29] An example would be a lawyer in country A working for her client in country B and sending the resulting expertise by fax to her client in country B.

[30] An example would be where a client from country B travels to country A where he receives face-to-face counselling from his lawyer.

[31] An example would be where a lawyer from country A establishes an office in country B, where locally employed staff work. 'Commercial presence' is defined in Art. XXVIII (Definitions) as follows: '(d) "commercial presence" means any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service'.

[32] An example would be where a lawyer from country A temporarily provides a service as an independent lawyer in country B (for example, by representing a client before a court in country B).

[33] 2001 Scheduling Guidelines, n. 25, 9.

The jurisprudence on GATS Article I:2 is limited. However, in *Mexico—Telecoms*, the Panel interpreted mode 1 ('cross border supply') and mode 3 ('commercial presence'). With regard to cross-border supply of services, it stated:

> The ordinary meaning of the words of this provision indicate that the *service* is supplied from the territory of one Member into the territory of another Member. Subparagraph (a) is silent as regards the *supplier* of the service. The words of this provision do not address the service supplier or specify where the service supplier must operate, or be present in some way, much less imply any degree of presence of the supplier in the territory into which the service is supplied. The silence of subparagraph (a) with respect to the supplier suggests that the place where the supplier itself operates, or is present, is not directly relevant to the definition of cross-border supply [emphasis in the original].[34]

With regard to mode 3 supply of services, the Panel stated:

> The definition of services supplied through a commercial presence makes explicit the location of the service supplier. It provides that a service supplier has a commercial presence—any type of business or professional establishment—*in the territory* of any other Member. The definition is silent with respect to any other territorial requirement (as in cross-border supply under mode 1) or nationality of the service consumer (as in consumption abroad under mode 2). Supply of a service through commercial presence would therefore not exclude a service that originates in the territory in which a commercial presence is established (such as Mexico), but is delivered into the territory of any other Member (such as the United States) [emphasis in the original].[35]

As the GATS addresses not only the product 'service', but also (and possibly in particular) 'services suppliers'—both as natural and juridical persons—mode 3 (commercial presence) essentially includes the acceptance of liberalizing investment. By allowing for example, foreign banks (or, for instance, foreign insurance companies) to sell banking services under mode 3, a WTO member is in fact opening up the banking sector to foreign investment. Note, that this far-reaching consequence does not follow automatically from being a WTO member and thus being bound by the GATS. Rather, something more is required: the specific liberalization of certain service sectors pursuant to the Schedule of Specific Commitments.[36]

Mode 4 service supply is generally perceived as liberalizing the *temporary* (and not permanent) presence of natural persons, despite GATS Article I:2 being silent on the duration of the stay following the movement of natural persons under mode 4. But paragraph 4 of the GATS Annex on Movement of Natural Persons Supplying Services under the Agreement reads:

> The Agreement shall not prevent a Member from applying measures to regulate the entry of natural persons into, or their *temporary stay* in, its territory, including those measures necessary to protect the integrity of, and to ensure the orderly movement of natural persons across, its borders, provided that such measures are not applied in

[34] *Mexico—Telecoms* (Panel), para. 7.30. [35] Ibid. para. 7.375. [36] See Chapter 21.

such a manner as to nullify or impair the benefits accruing to any Member under the terms of a specific commitment [emphasis added].

The Annex clarifies in paragraph 2 that the GATS does not apply to measures affecting natural persons seeking access to the employment market of a member, nor to measures related to residence, citizenship, or employment on a permanent basis. Therefore, despite the GATS not specifying a time frame for what should be considered a 'temporary stay', this term is defined negatively through the explicit exclusion of permanent presence.[37] The maximum length of stay allowed under mode 4 will depend on the purpose of the movement; in practice, the standard duration of stay undertaken in pertinent specific commitments would lie between three months for business visitors (BV) and five years for intra-corporate transferees (ICT).

3.3 Measure by a member

The GATS applies to measures by members affecting trade in services (GATS Article I:1). Pursuant to GATS Article XXVIII(a), 'measure' is broadly defined as 'any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form'. According to GATS Article XXVIII(c), it includes, inter alia, 'measures in respect of:

(i) the purchase, payment or use of a service;
(ii) the access to and use of, in connection with the supply of a service, services which are required by those Members to be offered to the public generally;
(iii) the presence, including commercial presence, of persons of a Member for the supply of a service in the territory of another Member'.

In order to be challenged in a formal WTO dispute settlement procedure, the measure in question must be identified by the complaining party. In *US—Gambling*, the Appellate Body stated that without demonstrating the source of the total prohibition, a complaining party may not successfully challenge a 'total prohibition' as a measure.

> [T]he alleged "total prohibition" on the cross border supply of gambling and betting services describes the alleged effect of an imprecisely defined list of legislative provisions and other instruments and cannot constitute a single and autonomous "measure" that can be challenged in and of itself.[38]

In *China—Publications and Audiovisual Products*, the Panel explained:

> A determination of whether something is a "measure" "must be based on the content and substance of the instrument, and not merely on its form or nomenclature." Acts

[37] cf. Antonia Carzaniga, 'The GATS, Mode 4, and Pattern of Commitments' in Aaditya Mattoo and Antonia Carzaniga, eds., *Moving People to Deliver Services* (Washington DC: The World Bank and Oxford University Press, 2003) 22.

[38] *US—Gambling* (Appellate Body), para. 126.

> setting forth rules or norms that are intended to have general and prospective application are measures subject to WTO dispute settlement.
>
> For example, the Panel and the Appellate Body in *US—Oil Country Tubular Goods Sunset Reviews*, determined that a non-binding policy bulletin had normative value because it provided administrative guidance and created expectations among the public and among private actors…
>
> Our task, then, is to determine whether the *Several Options*, the *Importation Procedure* and the *Sub-Distribution Procedure* are attributable to China and whether they set forth rules or norms that are intended to have general and prospective application [emphasis in the original].[39]

GATS Article I:3 defines the *addressees* of its disciplines broadly: 'measures by members' is explicitly defined as measures taken not only by central and regional authorities (the latter enjoying sometimes significant autonomy with regard to the regulation of services, as is the case for US states, Canadian provinces, or Swiss cantons), but also 'local authorities' and 'non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities'. While this in substance is not different from other agreements, as any measure attributable to the member[40] will be subject to the disciplines destined for members, it is noteworthy that the GATS explicitly refers to these entities, thereby possibly influencing the internal discourse. As a matter of fact, many liberal professions (such as the medical, legal, and accounting professions) are self-regulated on the basis of broad legislative mandates. Also, many of the leading traders of the world—Australia, Canada, Germany, Switzerland, the United States, and, of course, the EU—allocate many, if not most, regulatory competences to the sub-central entities.

3.4 Affecting trade in services

The question of whether a particular measure is a measure affecting trade in services, is a threshold issue for the applicability of the whole Agreement. In *EC—Bananas III*, the Appellate Body opted for a wide understanding of the term 'affecting trade in services':

> [T]he use of the term "affecting" reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word "affecting" implies a measure that has "an effect on", which indicates a broad scope of application.[41]

Thus, a measure may regulate goods, intellectual property, or animal welfare, but still 'affect' services.[42] For instance, any state measure that has an impact on the 'conditions of competition'[43] between suppliers of services 'affects' services for the purposes of

[39] *China—Publications and Audiovisual Products* (Panel), paras. 7.172, 7.173, and 7.175 (footnotes omitted).

[40] cf. Chapter II (Art. 5 *et seq.*) of the ILC Draft Articles on State Responsibility, *YILC* 2001, vol. II, Part Two.

[41] *EC—Bananas III* (Appellate Body), para. 220; cf. also *US—FSC (Article 21.5—EC)* (Appellate Body), para. 209.

[42] *EC—Bananas III* (Panel), para. 7.285.

[43] cf. ibid. para. 7.281 with regard to the GATS' MFN obligation.

GATS Article I:2. Therefore, the Appellate Body upheld a finding by the *EC—Bananas III* Panel that there was 'no legal basis for an *a priori* exclusion of measures within the EC banana import licensing regime from the scope of GATS'.[44]

However, even a wide understanding is not without limits. Whether a measure is indeed affecting trade in services was discussed in the *Canada—Autos* litigation. The Panel, when asked to review whether a duty-free exemption was a measure affecting trade in services, had based itself on the approach taken in *EC—Bananas III*, and decided that there was no a priori basis for exclusion of a measure.[45] However, the Appellate Body disagreed with the Panel's findings, as the latter had not conducted a market analysis to substantiate whether the measure in question had indeed satisfied the criterion 'affecting trade in services':[46]

> [A]t least two key legal issues must be examined to determine whether a measure is one "affecting trade in services": first, where there is "trade in services" in the sense of Article I:2; and, second, whether the measure in issue "affects" such trade in services within the meaning of Article I:1.[47]

The Appellate Body took the view that the first element of its two-pronged test was per se satisfied, if specific commitments had been negotiated in a given case. In the absence of specific commitments, the complaining party has to establish that 'trade in services' pursuant to one of the four modes discussed in the following was indeed affected.[48] With respect to the second element of the test, the Appellate Body develops its argument in three stages: first, it makes the point that since some measures can be scrutinized under both the GATT and the GATS it is imperative to explain how exactly a particular measure affects trade in goods or in services.[49] This first step was particularly important because Canada argued that the measures at hand affected only trade in goods. In the Appellate Body's view, the Panel had not examined any evidence relating to the provision of wholesale trade services of motor vehicles in the Canadian market, thus assuming a particular market situation without any proper review.[50] As a consequence, the Appellate Body rejected the Panel's relevant findings as simply 'not good enough'.[51]

The *Canada—Autos* test has been further elaborated in *US—Gambling*. There, the Panel was of the view that specific measures which resulted in a total prohibition on the cross-border supply of betting and gambling services were measures affecting trade in services, whereas the total prohibition was the effect of such measures.[52] Hence, absence of identification of the specific measures may be fatal for the complainant's chance of success. While the United States had (possibly inadvertently) granted market access, it nevertheless had some (federal and state) laws in place which outlawed internet gambling, irrespective of whether the service supplier was domestic or foreign.[53] However, the United States had, in the complainant's view, failed to indicate

[44] *EC—Bananas III* (Appellate Body), para. 220. [45] *Canada—Autos* (Panel), para. 10.234.

[46] It should be noted that the measure at hand was a Canadian measure reserving some advantages to a particular sub-set of all car distributors in Canada.

[47] *Canada—Autos* (Appellate Body), para. 155. [48] See further ibid. para. 157.

[49] Ibid. paras. 160, 161. [50] Ibid. paras. 164, 165. [51] Ibid. para. 166.

[52] *US—Gambling* (Panel), paras. 6.148–6.255.

[53] However, and decisively so, there were also instances of differential treatment.

in their schedule of concessions that they restricted the cross-border supply of internet gambling. The complainant, Antigua and Barbuda, was of the opinion that in the absence of such indication, the United States was not allowed to restrict internet gambling services originating in their territory. The Panel eventually accepted this claim; as the first step in its analysis, the Panel decided that the series of US state and federal laws satisfied the definition of a measure affecting trade in services. The Appellate Body upheld the Panel's finding that the total prohibition of betting and gambling as such was the effect of, and not the measure affecting trade in services.[54] It went on to identify the specific measures affecting trade which resulted in total prohibition:[55] According to the Appellate Body, an identification of the specific measure affecting trade in services is required, meaning that a complainant will need to demonstrate *how* the service at hand is being supplied in a given market, *who* supplies this service, and *how* the measure at hand affects the supply of the service in the same market.

4. General Obligations

GATS Part II addresses the members' 'general obligations', which they accept without further undertaking in their schedules. Some of these 'general obligations' apply to all services sectors regardless of the existence of specific commitments ('unconditional general obligations'), while others only become operational upon specific liberalization commitments undertaken by a member and reflected in its schedule of commitments ('conditional general obligations').

4.1 Unconditional general obligations

4.1.1 General most favoured nation obligation

Whereas Article II contains GATS' general MFN obligation, specific MFN provisions implement the non-discrimination principle throughout the GATS.[56] GATS Article II:1 reads:

> With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to *like services and service suppliers* of any other country [emphasis added].

In parallel with GATT Article I, GATS Article II imposes on WTO members the obligation to accord unconditionally and automatically to any other WTO member treatment no less favourable than the treatment they accord to like services and like service suppliers from any other country (whether a WTO member or not). The MFN requirement is a powerful instrument for small countries lacking the economic leverage or administrative resources to negotiate effectively with large trading

[54] *US—Gambling* (Appellate Body), para. 126. [55] Ibid. para. 133 *et seq.*
[56] cf., for instance, GATS Art. VII:2, Art. VIII:1, and Arts. X, XII, and XXI.

partners: it ensures that these countries will, nevertheless, enjoy the benefits of trade liberalizations.[57]

The Panel report in *EC—Bananas III* confirmed that the MFN obligation applies to all services sectors and suppliers irrespective of whether specific commitments have been undertaken:

> [T]his provision constitutes a general obligation which is, in principle, applicable across the board by all Members to all services sectors, not only in sectors or sub-sectors where specific commitments have been undertaken. Any exception to this general obligation would have to be provided for explicitly in accordance with the terms of the GATS.[58]

Pursuant to *Canada—Autos*, examining a claim based on GATS Article II:1 should proceed in three steps:

1. A 'threshold determination must be made under Article I:1 that the measure is covered by the GATS';[59] the parameters necessary for answering this question have been answered earlier.
2. Further it must be established that the pertinent 'services and services suppliers' are 'like' services and service suppliers of 'any other country', that is, not just any WTO member.[60]
3. Finally, the Panel needs to establish whether the 'treatment by one Member of "services and services suppliers" of any other Member' is 'treatment no less favourable'.[61] We shall discuss the last two points in turn.

4.1.1.1 Likeness of services and likeness of services suppliers

The notion of likeness is an old acquaintance of the readers of this book by now.[62] Article II prohibits discrimination between 'like services' but also 'like service suppliers'. Hence questions such as the following arise: Are New Zealand-trained nurses 'like' South Africa-trained nurses? Are silent movie showings 'like' the showing of motion pictures with synchronized sound? Is selling CDs and LPs 'like' streaming music via the Internet? Is a 'Big 5' accounting firm with hundreds of partners 'like' your shopping mall's self-employed tax accountant?

In view of the similarity of the wording and the functions of GATT Article I and GATS Article II, the appropriateness of drawing on the 'likeness' jurisprudence concerning GATT Articles I (and III) is nearly universally recognized; so is the necessity to avoid applying these criteria mechanically, but with a view to the specific nature of trade in services. This, clearly, is what the Appellate Body has already emphasized in the context of GATT: the criteria developed are supposed to help to determine whether a competitive relationship exists, which is to be manipulated by the discriminatory state intervention. The famous 'Border Tax Adjustment' criteria—end-use in a given market, consumer

[57] Nellie Munin, *Legal Guide to GATS* (Kluwer Law International, 2010) 106.
[58] *EC—Bananas III* (Panel), para. 7.298. [59] *Canada—Autos* (Appellate Body), para. 170.
[60] Ibid. para. 171. [61] Ibid.
[62] See the extensive use of dictionaries to explore the literal meaning in *EC—Asbestos* (Appellate Body), para. 90 *et seq*.

tastes and habits, a product's properties (nature and quality), and, in addition to the classic Border Tax Adjustment test, tariff classifications—are merely indicators used by the Appellate Body and the Panels for their case-by-case determination. Thus, the different nature of services when compared to goods influences the analysis; in that context, it is noteworthy that the CPC is not drafted at a level of detail similar to HS.

So far, the Appellate Body has not discussed likeness in GATS Article II in a comprehensive manner. At the time of writing, Panels could benefit from Panel jurisprudence on 'likeness' in the context of GATS Article XVII:[63]

> [L]ike services and service suppliers' analyses should in our view take into account the particular circumstances of each case ... [and] should be made on a case-by-case basis.
>
> In the light of the above, we consider that a likeness determination should be based on arguments and evidence that pertain to the competitive relationship of the services being compared. As in goods cases where a panel assesses whether a particular product is a "like product", the determination must be made on the basis of the evidence as a whole. If it is determined that the services in question in a particular case are essentially or generally the same in competitive terms, those services would, in our view, be "like".[64]

A first direct attempt to interpret 'likeness' as used in GATS Article II had been made in *EC—Bananas III*:

> [W]holesale transactions as well as each of the different subordinated services mentioned in the headnote to section 6 of the CPC are "like" when supplied in connection with wholesale services, irrespective of whether these services are supplied in respect of bananas of EC and traditional ACP origin, on the one hand, or with respect to bananas of third-country or non-traditional ACP origin, on the other, and that, in our view, at least to the extent that entities provide these like services, they are like service suppliers ...[65]

In *Canada—Autos*, the Panel dealt with the issue of whether 'manufacture beneficiaries' and 'non-manufacture beneficiaries' were like services suppliers 'regardless of whether or not they had production facilities in Canada'.[66] The issue was not whether the mode of supply influences the issue of whether two services (or two services suppliers) are like, since both sets of distributors were established under mode 3. Rather, the issue was much narrower, namely whether a difference in the type of operations[67] undertaken by two distributors was enough to make them unlike suppliers. The Panel responded in the negative:

> The complainants argue, and Canada does not contest, that manufacturer beneficiaries and non-manufacturer-beneficiaries provide "like" services and are "like" service suppliers, irrespective of whether their services are supplied with respect to motor

[63] Note that already in *EC—Bananas III (Article 21.5—Ecuador)*, the Panel stated at paras. 6.95 and 6.104 that likeness pursuant to GATS Art. II and GATS Art. XVII should be examined together.

[64] *China—Electronic Payment Services* (Panel), paras. 7.701–7.702, referring to the Appellate Body's 'likeness' determinations in the context of GATT Art. III: *EC—Asbestos* (Appellate Body), paras. 99, 101, 103; *Japan—Alcoholic Beverages II* (Appellate Body), 113, and *Philippines—Distilled Spirits* (Appellate Body), fn. 211.

[65] *EC—Bananas III* (Panel), para. 7.346.

[66] *Canada—Autos* (Panel), para. 6.843.

[67] Ibid. paras. 6.860–6.862.

> vehicles imported by the manufacturer beneficiaries or with respect to motor vehicles imported by non-manufacturer-beneficiaries, and regardless of whether or not they have production facilities in Canada.
>
> We agree that to the extent that the service suppliers concerned supply the same services, they should be considered "like" for the purpose of this case.[68]

The Panel did not discuss in a comprehensive manner the criteria under which the fact that some distributors were performing tasks that others did not could be relevant from a regulator's perspective, or whether this perspective is completely immaterial and likeness will be defined exclusively by looking at the marketplace.

4.1.1.2 Immediately and unconditionally

Pursuant to GATS Article II:1, WTO members have the obligation to accord treatment no less favourable than that accorded to any service or service supplier of any country to like services or services suppliers of any WTO Member *immediately and un-conditionally*.

These terms have been interpreted both in the GATT and the GATS context. There is little doubt that the term 'immediately' essentially imposes on WTO members the obligation to extend a benefit already granted to a service or service supplier without any delay, provided all requirements, such as likeness, have been satisfied.

With regard to the term 'unconditionally', two interpretations seem possible, and have already been discussed in the context of GATT Article I:

> The . . . obligation to accord "unconditionally" to third countries which are WTO Members an advantage which has been granted to any other country means that the extension of that advantage may not be made subject to conditions with respect to the situation or conduct of those countries. . . .
>
> In this respect, it appears to us that there is an important distinction to be made between, on the one hand, the issue of whether an advantage within the meaning of Article I:1 is subject to conditions, and, on the other, whether an advantage, once it has been granted to the product of any country, is accorded "unconditionally" to the like product of all other Members. An advantage can be granted subject to conditions without necessarily implying that it is not accorded "unconditionally" to the like product of other Members. More specifically, the fact that conditions attached to such an advantage are not related to the imported product itself does not necessarily imply that such conditions are discriminatory with respect to the origin of imported products.[69]

The latter view would seem preferable also in the context of the GATS, as it allows GATS Article II to be operational without unduly burdening a sovereign state with an obligation that was not clearly imposed by the text of the treaty (*in dubio mitius*).

4.1.1.3 Less favourable treatment

Transferring the insights of its relevant GATT jurisprudence, the Appellate Body held that both de jure as well as de facto discrimination are covered by GATS Article

[68] *Canada—Autos* (Panel), paras. 10.247 and 10.248.

[69] Ibid. paras. 10.23–10.24; this line of jurisprudence goes back to *Belgium—Family Allowances* (GATT Panel Report, Belgian Family Allowances, G/32, adopted 7 November 1952, B.I.S.D. 1S/59).

II. This result is less clear-cut than it would seem, due to the fact that GATS Article XVII explicitly also covers de facto discrimination. *A contrario*, one could argue that the provision of GATS Article II only covers de jure discrimination. The Appellate Body did not agree to that:

> There is more than one way of writing a *de facto* non-discrimination provision. Article XVII of the GATS is merely one of many provisions in the WTO Agreement that require the obligation of providing "treatment no less favourable". The possibility that the two Articles may not have exactly the same meaning does *not* imply that the intention of the drafters of the GATS was that a *de jure*, or formal, standard should apply in Article II of the GATS. If that were the intention, why does Article II not say as much? The obligation imposed by Article II is unqualified. The ordinary meaning of this provision does not exclude *de facto* discrimination. Moreover, if Article II was not applicable to *de facto* discrimination, it would not be difficult—and, indeed, it would be a good deal easier in the case of trade in services, than in the case of trade in goods—to devise discriminatory measures aimed at circumventing the basic purpose of that Article . . .[70]

Informed by the jurisprudence on GATT Articles I and III, and in particular on GATS Article XVII, it is fair to say that any showing that a state intruded into the competitive relationship between services or service providers establishes treatment less favourable for the purposes of GATS Article II.

> Ecuador has established . . . less favourable treatment in the meanings of Articles II and XVII . . . [by showing] that its service suppliers do not have opportunities to obtain access to import licences on terms equal to those enjoyed by service suppliers of EC/ ACP origin under the revised regime and carried on from the previous regime. . . . [T]he revised licence allocation system reflecting licence usage and payment of customs duties during the 1994–1996 period displays *de facto* discriminatory structure.[71]

4.1.2 MFN exceptions

4.1.2.1 Annex on MFN exemptions

In what is in practice a very significant reduction of the coverage of GATS' general MFN obligation, GATS Article II:2 allows for deviations from MFN under the condition that the relevant (as such Article II-inconsistent) measure is listed according to conditions established in the Annex on Article II GATS Exemptions. Each member had the one-off opportunity[72] to submit such a list of MFN exemptions and departures from MFN treatment at the date of entry into force of the WTO Agreement.[73] Paragraph 2 of

[70] *EC—Bananas III* (Appellate Body), para. 233.

[71] *EC—Bananas III (Article 21.5—Ecuador)* (Panel), para. 6.133.

[72] Rudolf Adlung and Antonia Carzaniga, 'MFN Exemptions under the General Agreement on Trade in Services: Grandfathers Striving for Immortality?' (2009) *J. of Int'l. Econ. Law* 12, 357–92.

[73] This right could, pursuant to the wording of the provision, be exercised by each original WTO member at the GATS' entry into force in 1995; for new members, the relevant date would be the date of accession to the WTO; see, Rüdiger Wolfrum, 'Annex on Article II Exemptions' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law:*

the Annex on Article II GATS Exemptions states that new exemptions can only be added pursuant to GATS Article IX:3. According to this provision, if three-fourths of the members deem this to be appropriate, they will exempt a member from the ordinary obligations of the WTO Agreement 'in exceptional circumstances'.

'Exemptions lists' contain five columns: the first for the sector or sub-sector exempted; the second for a description of the measure, indicating its inconsistency with Article II; the third indicating the countries to which the measure applies; the fourth indicating the intended duration; and the fifth indicating the conditions that created the need for the exemption.

Pursuant to paragraph 6 of the Annex on Article II GATS Exemptions, the duration of Article II:2 exemptions should 'in principle' not exceed a period of ten years; in any case, they shall be subject to negotiation in subsequent trade rounds. Exemptions granted for more than five years will be subject to review by the Council for Trade in Services (CTS), pursuant to paragraph 4 of the Annex on Article II GATS Exemptions.

Several countries have indicated that the duration of their listed exemption was 'indefinite'. This seems problematic: While the wording of the Annex does not oblige the members to end the measures after ten years, it does impose a duty to negotiate in good faith, with the aim of terminating the deviation from the normative standard that is the MFN treatment. Thus, in order not to be WTO-incompatible, the qualification of a GATS Article II exemption as 'indefinite' must be read as meaning *until revocation as a consequence of negotiations (undertaken in good faith) pursuant to para. 6 of the Annex.* Since the end of the initial ten-year period, several reviews have taken place; no revocation of any exemption has been recorded.[74]

Finally, GATS Article II only allows exemptions from MFN, not from other obligations. Hence, a member may accord to scheduled preferred members market access and national treatment that is more favourable than that which it has agreed to as 'specific commitments' without being obliged to accord the same treatment to other members, as would normally follow from GATS Article II. However, scheduled commitments (both under GATT Article II:7 and pursuant to GATS Article XX) are a minimum standard, from which *downward* deviations are legally not permissible under exception clauses that liberate from MFN obligations.[75]

Thus, an Article II exemption creates the possibility for far-reaching differential treatment. If one takes further into account that members remain free not to enter into

WTO—Trade in Services, Vol. 6, n. 18, 569 *et seq*. Note that Protocols of Accession are comprehensively negotiated documents.

[74] cf. WTO Doc. S/C/M/44, Council for Trade in Services, Council Review of MFN Exemptions—Report of the Meeting Held on 29 May 2000; WTO Doc. S/C/M/45, Council for Trade in Services, Council Review of MFN Exemptions—Report of the Meeting Held on 5 July 2000; WTO Doc. S/C/M/47, Council for Trade in Services, Council Review of MFN Exemptions—Report of the Meeting Held on 5 October 2000; WTO Doc. S/C/M/76, Council for Trade in Services, Report of the Meeting Held on 30 November 2004; WTO Doc. S/C/M/78, Council for Trade in Services, Report of the Meeting Held on 23 February 2005; WTO Doc. S/C/M/105, Report of the Meeting held on 2 May 2011. Note the somewhat resigned description of the state of play by the representative of Hong Kong, ibid. para. 31. At its meeting in May 2011 the Council agreed to hold the next review of Article II (MFN) in 2016.

[75] But cf. scheduled conditions and limitations, for example, pursuant to GATS Art. XVI:2.

any specific commitment, the difference to the WTO regime regarding trade in goods is almost shocking.[76]

4.1.2.2 Economic integration

In parallel to GATT Article XXIV, GATS Article V allows WTO members to deviate from their treaty obligations as a consequence of having entered into a preferential trade agreement (PTAs, used synonymously with free trade agreements, FTAs),[77] provided the FTA establishes a significant degree of economic integration.[78] This is to avoid preferred treatment whose only purpose would be the naked discrimination of other WTO partners. 'Closer economic relations' between (regional) partners have in the past proven beneficial to *all* trading partners in the long run, despite typical initial losses for non-participants at the beginning of any new preferential regime. GATS Article V:1 reads in relevant parts:

> This Agreement shall not prevent any of its Members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such an agreement, provided that such an agreement:
> (a) has substantial sectoral coverage, and
> (b) provides for the absence or elimination of substantially all discrimination, in the sense of Article XVII, between or among the parties, in the sectors covered under subparagraph (a), through:
>   (i) elimination of existing discriminatory measures, and/or
>   (ii) prohibition of new or more discriminatory measures,
> either at the entry into force of that agreement or on the basis of a reasonable time-frame, except for measures permitted under Articles XI, XII, XIV and XIV *bis* [footnote omitted].

GATS Article V is complemented by its sister provision GATS Article V *bis*, which has no direct counterpart in GATT, as it focuses only on one (albeit politically particularly sensitive) subject, free movement of workers:

> This Agreement shall not prevent any of its Members from being a party to an agreement establishing full integration[79] of the labour markets between or among the parties to such an agreement, provided that such an agreement:

[76] Rüdiger Wolfrum, 'Art. II GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, Vol. 6, n. 18 at 91.

[77] For an analysis of the services chapters of the RTA that have been notified to the WTO see Federico Ortino, 'Services' in Simon Lester and Bryan Mercurio, eds., *Bilateral and Regional Trade Agreements, Commentary and Analysis* (Cambridge University Press, 2009) 184–214.

[78] On this point, see Bernard Hoekman and Pierre Sauvé, 'Regional and Multilateral Liberalization of Trade in Services: Complements or Substitutes?' (1994) *Journal of Common Market Studies* 32, 289–317, and Sherry Stephenson, 'GATS and Regional Integration' in Pierre Sauvé and Robert Stern, *The GATS 2000: New Directions in Services Trade Liberalization* (Brookings, 2000), n. 5 at 509–29.

[79] '[Footnote 2 in the original] Typically, such integration provides citizens of the parties concerned with a right of free entry to the employment markets of the parties and includes measures concerning conditions of pay, other conditions of employment and social benefits.' cf. for an example the Agreement between the European Community and its Member States, of the one part, and the Swiss Confederation of the other, on the free movement of persons, *OJ* L 114/1 of 30.4.2002.

(a) exempts citizens of parties to the agreement from requirements concerning residency and work permits;
(b) is notified to the Council for Trade in Services.

In the following we briefly discuss some of the conditions of GATS Article V:

(a) Agreement liberalizing trade. A first question is whether the term 'agreement liberalizing trade in services' is defined by the following sub-paragraphs (discussed below, *(b) to (e)*), or rather has a distinct content that surpasses those four elements. Much could be said for the latter view: it is rare indeed that the WTO agreements speak of liberalizing trade in services, and the principle of effective treaty interpretation would indicate that this choice of words ought to mean something. On the other hand, the parallelism between GATT Article XXIV and GATS Article V would rather indicate that the remainder of Article V defines the term 'agreement liberalizing trade in services'.

(b) Substantial sectoral coverage. The first condition that an FTA needs to fulfil to be covered by GATS Article V is 'substantial sectoral coverage'. This term is explained by footnote 1:

> This condition is understood in terms of number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the *a priori* exclusion of any mode of supply.

It will be recalled that according to GATT Article XXIV:8 'substantially all the trade' needs to be covered by an FTA in order to deviate in WTO-compatible fashion from the normal obligations. Despite the fact that GATS is the more recent and modern agreement, and indeed undertakes some effort to explain its coverage, the notion of 'substantial sectoral coverage' remains far from self-explanatory. With regard to 'substantially all the trade' the Appellate Body, in *Turkey—Textiles*, stated that this condition required less than 'all the trade', and somewhat more than 'some of the trade'.[80] Similarly, the definition of what 'substantial sectoral coverage' means will have to be determined on a case-by-case basis: How many sectors have to be included? How is it possible to quantify the 'volume of trade in services'? In addition, the footnote states that, a priori, all modes of supply should be included. However, the degree of liberalization in each mode of supply is not specified.[81]

(c) Elimination of substantially all discrimination. The second condition for a PTA to be considered WTO-compatible is the 'elimination of substantially all discrimination' by granting national treatment to the services *and* service suppliers of the other PTA contracting party (or parties):[82] This is to be effectuated by 'elimination of existing discriminatory measures, and/or prohibition of new or more discriminatory

[80] *Turkey—Textile* (Appellate Body), para. 48.
[81] See Thomas Cottier and Martin Molinuevo, 'Art. V GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18 at 132.
[82] *Canada—Autos* (Panel), para. 10.270.

measures'.[83] Thus, Article V allows members to maintain some discriminatory measures between or among the parties to a PTA, provided, however, that overall 'substantially all discrimination' has been eliminated from the covered sectors, among or between *all* the parties of the agreement.[84]

(d) Conditions regarding trade with third parties. While members concluding an FTA may raise some barriers to trade with the remaining WTO membership, they have to ensure that (on average) the market access conditions remain the same (which requires increased liberalization in other areas to compensate for potential raises). Here again, GATS is trying to keep the balance between bilateral and multilateral liberalization, by ensuring that PTAs do not substantially affect the legal *status quo ante*. Furthermore, Article V:5 provides that

> [i]f, in the conclusion, enlargement or any significant modification of any agreement under paragraph 1, a Member intends to withdraw or modify a specific commitment inconsistently with the terms and conditions set out in its Schedule, it shall provide at least 90 days advance notice of such modification or withdrawal and the procedure set forth in paragraph 2, 3, and 4 of Art. XXI shall apply.

Thus, third parties have to be compensated if the modification of schedules under GATS Article XX (necessitated by the conclusion of a PTA) affects them negatively. The member intending to withdraw or modify its specific commitments is obliged to notify that intention and engage in negotiations to find appropriate compensation. If such negotiations do not lead to mutually satisfactory results, compensation will be determined by arbitration (GATS Article XXI).

(e) Transparency. GATS Article V:7 obliges parties to an FTA to notify such agreement and any enlargement or modification of that agreement to the CTS.[85] According to the *General Council Decision on the Transparency Mechanism for Regional Trade Agreements*,[86] such notification should take place directly after the ratification of the agreement and before the application of preferential treatment between or among parties. In practice, notifications are systemically late. Once the notification is received, the CTS may establish a Working Party to examine such an agreement. Based on the

[83] cf. Martin Roy, Juan Marchetti, and Hoe Lim, 'Services Liberalization in the New Generation of Preferential Trade Agreements (PTAs): How Much Further than the GATS?' (2007) *World Trade Review* 6, 92; Henrik Horn, Petros Mavroidis, and Andre Sapir, *Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements*, Bruegel Blueprint Series, Vol. 6 (Brussels: Bruegel, 2009).

[84] *Canada—Autos* (Panel), para. 10.270. On the other hand, the obligation to liberalize includes the obligation to eliminate existing discriminatory measures 'and/or' the prohibition to introduce new restrictive measures. In light of the aim of Art. V:1(b) to guarantee a level playing field between or among the parties to a FTA that ensures true economic integration (and to achieve the 'elimination of substantially all discrimination'), the correct reading of that provision ought to be not only to eliminate the current discriminatory measures but also to ensure that the assumed level of liberalization will not be lowered by the parties in the future.

[85] As of 7 April 2015 the WTO has received 147 notifications of RTAs under GATS Art. V; in the period from 1 January to 15 October 2014 there were eight notifications of RTAs in services, WTO Doc. WT/REG/24, Report (2014) of the Committee on Regional Trade Agreements to the General Council, 11 November 2014. More information is available at <https://www.wto.org/english/tratop_e/region_e/region_e.htm>.

[86] *General Council Decision on the Transparency Mechanism for Regional Trade Agreements*, WTO Doc. WT/L/671, 18 December 2006.

reports of the Working Party, the Council may make recommendations. If a PTA is implemented incrementally on the basis of a time frame, members shall report periodically to the CTS on its implementation.

4.1.2.3 Mutual recognition agreements

The legal basis for a third important exception from MFN is provided by GATS Article VII:

> For the purposes of the fulfilment . . . of its standards or criteria for the authorization, licensing or certification of services suppliers . . . a Member may recognize the education or experience obtained, requirements met, or licenses or certifications granted in a particular country. Such recognition, which may be achieved through harmonization or otherwise, may be based upon an agreement or arrangement with the country concerned or may be accorded autonomously.

Mutual recognition agreements (MRAs) of the kind described in this Article are particularly important for the supply of services under mode 4. Clearly, such agreements put service providers from MRA partners in a better position than service providers from 'regular' WTO members, thus creating an obstacle to MFN treatment. WTO members entering into such agreements are required to promptly notify the WTO about negotiations and conclusion of such an agreement. Most importantly though, negotiators added an MFN-inspired obligation in paragraphs two and three to keep accession to such MRA open to the entire membership:

> A Member that is a party to an agreement or arrangement of the type referred to in paragraph 1, whether existing or future, shall afford adequate opportunity for other interested Members to negotiate their accession to such an agreement or arrangement or to negotiate comparable ones with it. Where a Member accords recognition autonomously, it shall afford adequate opportunity for any other Member to demonstrate that education, experience, licenses, or certifications obtained or requirements met in that other Member's territory should be recognized.
>
> A Member shall not accord recognition in a manner which would constitute a means of discrimination between countries in the application of its standards or criteria for the authorization, licensing or certification of services suppliers, or a disguised restriction on trade in services.

While, in principle, MRAs will have to be accessible on a non-discriminatory basis, many variables determine and affect discrimination in the context of services. Interested parties will be confronted with a significant obstacle whenever they request to join an MRA.[87]

GATS Article VII:5 tries to reduce the scope for arbitrariness by encouraging members, wherever appropriate, to use recognition 'based on multilaterally agreed criteria'; however, such multilaterally agreed criteria are the exception to the rule.[88]

[87] Aaditya Mattoo, 'MFN and the GATS' in Thomas Cottier and Petros Mavroidis, eds., *Regulatory Barriers and the Principle of Non Discrimination* (University of Michigan Press, 2000) 51–99.

[88] WTO members have agreed on some disciplines applicable in the accountancy sector, although the final document reflects hortatory and not legally binding language; also, WTO members recognize the

Regulatory cooperation between members aims not only to reduce inefficient regulatory diversity, but 'it is also about limiting or reducing the costs associated with *necessary* regulatory diversity'.[89] The identity of the players involved in MRAs is a good argument supporting the intuitive view that a certain degree of homogeneity is a necessary prerequisite for a successful conclusion of an MRA. The European Union experience gives additional support to this view.[90]

4.1.3 Transparency

According to GATS Article III:1, each WTO member shall publish promptly all relevant measures of general application which pertain to or affect the operation of the GATS. Furthermore, GATS Article III:4 establishes the obligation to respond to all requests for specific information on any of its measures of general application. To this effect, members establish inquiry points to provide specific information upon request.[91] This obligation is somewhat reinforced by the provision on cross-notifications: pursuant to GATS Article III:5, a WTO member may notify GATS-related legislation adopted by another WTO member.

4.1.4 Domestic regulation

GATS Article VI contains procedural and substantive obligations as to members' domestic regulatory regimes of services, most of which refer to specific obligations that will be discussed in section 4.2. The procedural obligation prescribed by GATS Article VI:2 is of unconditional general application and provides that WTO members must ensure adjudication of cases concerning trade in services in an impartial and objective manner: administrative decisions affecting services suppliers should be subject to prompt review. Article VI:2(b) illustrates how far-reaching this demand may be, which asks for nothing less than administrative review by independent courts, a demand that is clearly revolutionary for some members' systems of governance.

4.1.5 Competition-related requirements

GATS Articles VIII and IX impose specific obligations on all WTO members with regard to the treatment of monopolies (and exclusive services suppliers), and restrictive

International Standardization Organization (ISO) and the International Telecommunications Union (ITU) standards and their contribution to the inter-operability of telecommunication networks; the WTO Secretariat circulated a document reporting a series of multilateral and 'regional' initiatives covering standards in various sectors (WTO Doc. S/C/W/97 of 1 March 1999).

[89] WTO Doc. G/TBT/W/340, 7 September 2011, Committee on Technical Barriers to Trade, *Regulatory Cooperation between Members*, Background Note by the Secretariat, para. 4.

[90] cf. Americo Beviglia-Zampetti, 'Market Access through Mutual Recognition' in Pierre Sauvé and Robert Stern, *The GATS 2000: New Directions in Services Trade Liberalization* (Brookings, 2000), n. 5 at 283–306 which draws on the EC experience, and Kalypso Nicolaidis and Joel Trachtman, 'From Policed Regulation to Managed Recognition in GATS' in Pierre Sauvé and Robert Stern, *The GATS 2000: New Directions in Services Trade Liberalization*, n. 5 at 241–82.

[91] GATS Art. III:4.

business practices (RBPs). With respect to trade in telecommunications services, these rules are modified and expanded in the so-called Reference Paper.[92] GATS Articles VIII:1 and IX essentially request WTO members to ensure that their monopolies and exclusive services suppliers will not operate in a MFN-inconsistent manner and/or will de facto call into question their specific commitments. In addition, Article IX:2 obliges members to enter, upon request, into consultation with any other member with a view to eliminating practices that restrain competition. In *Mexico—Telecoms*, the Panel took the view that differential pricing by an entity covered by GATS Article VIII would constitute a violation of the said provision as it runs counter to GATS Article II.[93]

4.2 Conditional general obligations

4.2.1 Domestic regulation

GATS Article VI:1, VI:3, and VI:6 contain *conditional* procedural general obligations,[94] as they apply only in sectors with specific commitments. Article VI:4 and VI:5 lay down substantive, albeit rather soft, obligations for domestic regulation.[95]

4.2.1.1 Developing disciplines on domestic regulation

GATS Article VI:4 calls upon the Council for Trade in Services to establish disciplines aimed at ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services:

> Such disciplines shall aim to ensure that such requirements are, inter alia:
>
> (a) based on objective and transparent criteria, such as competence and the ability to supply the service;
>
> (b) not more burdensome than necessary to ensure the quality of the service;
>
> (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.

[92] <http://www.wto.org/english/tratop_e/serv_e/telecom_e/tel23_e.htm>.

[93] *Mexico—Telecoms* (Panel), paras. 7.133 and 7.137.

[94] Art. VI:1 requires members to administer all measures of general application affecting trade in services in a reasonable, objective, and impartial manner in sectors where specific commitments have been undertaken. Art. VI:3 states that where an authorization is required for the supply of a service for which specific commitments have been undertaken, the competent authorities of members shall inform an applicant of the decision concerning the application within a reasonable period of time after the submission of a complete application and shall keep the applicant informed about the status of the application upon request. Art. VI:6 requires the establishment of adequate procedures to verify the competence of foreign professionals in sectors where specific commitments regarding professional services have been undertaken (WTO Doc. S/C/W/96, Council for Trade in Services, *Article VI:4 of the GATS: Disciplines on Domestic Regulation Applicable to All Services*, 1 March 1999).

[95] On this issue, see the excellent analysis by Panagiotis Delimatsis, *Domestic Regulation and International Trade in Services: Necessity, Transparency and the Effects of Domestic Regulatory Measures on Foreign Entry* (Switzerland: University of Neuchâtel, 2006). See also Geza Feketekuty, 'Regulatory Reform and Trade Liberalization in Services' in Pierre Sauvé and Robert Stern, *The GATS 2000: New Directions in Services Trade Liberalization* (Brookings, 2000), n. 5 at 225–40.

Attempting to define the scope of GATS Article VI:4, the Working Party on Professional Services (WPPS) considered it useful to distinguish between the different categories and sub-categories of measures covered by this Article:[96]

- *Qualification requirements*: these comprise substantive requirements which a professional service supplier is required to fulfil in order to obtain certification or a licence. They normally relate to matters such as education, examination requirements, practical training, experience, or language requirements.
- *Qualification procedures*: these are administrative or procedural rules relating to the administration of qualification requirements. They include procedures to be followed by candidates to acquire a qualification, including the administrative requirements to be met. This covers inter alia where to register for education programmes, conditions of registration, documents to be filed, fees, mandatory physical presence conditions, alternative ways to follow an educational programme (for example, distance learning), alternative routes to gain a qualification (for example, through equivalences), and organizing of qualifying examinations.
- *Licensing requirements*: these are substantive requirements, other than qualification requirements, with which a service supplier is required to comply in order to obtain formal permission to supply a service. They include measures such as residency requirements, fees, establishment requirements, registration requirements.
- *Licensing procedures*: these are administrative procedures relating to the submission and processing of an application for a licence, covering such matters as time frames for the processing of a licence, and the number of documents and the amount of information required in the application for a licence.
- *Technical standards*: these are requirements which may apply both to the characteristics or definition of the service itself and to the manner in which it is performed. For example, a standard may stipulate the content of an audit, which is akin to definition of the service; another standard may lay down rules of ethics or conduct to be observed by the auditor.

The relevant work in this field has thus far been limited,[97] however, the work of the Working Party on Professional Services (WPPS) in the accountancy sector is worth mentioning. According to their non-binding *Guidelines for mutual recognition of accountancy qualifications*,[98]

[96] WTO Doc. S/WPPS/W/9, Working Party on Professional Services, *The Relevance of the Disciplines of the Agreements on Technical Barriers to Trade (TBT) and on Import Licensing Procedure to Art. VI:4 of the GATS*, Note by the Secretariat, 11 September 1996.

[97] WTO Doc. S/WPPS/W/1 (Working Party on Professional Services, *Functions of the Working Party on Professional Services in Relation to Accountancy*, 27 June 1995), WTO Doc. S/WPPS/W/12/Rev. 1 (Working Party on Professional Services, *Guidelines for Mutual Recognition Agreements or Arrangements in the Accounting Sector*, Revision, 20 May 1997), and WTO Doc. S/WPPS/W/14/Rev. 1 (Working Party on Professional Services, *Recommendation of the Working Party on Professional Services to the Council for Trade in Services*, 15 May 1997); see also <http://www.wto.org/english/news_e/pres97_e/pr73_e.htm>.

[98] WTO Doc. S/WPPS/W/12/Rev. 1, Working Party on Professional Services, *Guidelines for Mutual Recognition Agreements or Arrangements in the Accounting Sector*, Revision, 20 May 1997.

(a) any WTO member wishing to enter into a mutual recognition agreement (in accordance with GATS Article VII) with another WTO member, under which it acknowledges that accountants from another WTO member fulfil the criteria imposed by their domestic legislation, will have to promptly notify the GATS Council;
(b) the pertinent WTO member 'shall afford adequate opportunity for other interested Members to negotiate their accession to such an agreement or arrangement or to negotiate comparable ones with it. Where a member accords recognition autonomously, it shall afford adequate opportunity for any other Member to demonstrate that education, experience, licenses, or certifications obtained or requirements met in that other Member's territory should be recognized';
(c) WTO members, whenever appropriate, shall base their decisions on recognition on mutually agreed criteria.

The CTS also adopted the Disciplines on Domestic Regulation in the Accountancy Sector,[99] which are applicable to members who have entered specific commitments on accountancy in their schedules.[100] The most remarkable feature in the Disciplines is the inclusion of an accountancy sector-specific necessity test which reads as follows:[101]

> Members shall ensure that measures not subject to scheduling under Articles XVI or XVII of the GATS, relating to licensing requirements and procedures, technical standards and qualification requirements and procedures are not prepared, adopted or applied with a view to or with the effect of creating unnecessary barriers to trade in accountancy services. For this purpose, Members shall ensure that such measures are not more trade-restrictive than necessary to fulfil a legitimate objective. Legitimate objectives are, inter alia, the protection of consumers (which includes all users of accounting services and the public generally), the quality of the service, professional competence, and the integrity of the profession. [footnote omitted]

On 26 April 1999, the WTO members adopted another decision in the context of GATS Article VI, which reads in relevant parts:[102]

> 1. A Working Party on Domestic Regulation shall be established and the Working Party on Professional Services shall cease to exist.
> 2. In accordance with paragraph 4 of Article VI of the GATS, the Working Party shall develop any necessary disciplines to ensure that measures relating to licensing requirements and procedures, technical standards and qualification requirements and procedures do not constitute unnecessary barriers to trade in services. This shall also encompass the tasks assigned to the Working Party on Professional Services, including the development of general disciplines for professional services

[99] WTO Doc. S/L/63, *Decision on Disciplines Relating to the Accountancy Sector*, Adopted by the Council for Trade in Services on 14 December 1998, 15 December 1998.
[100] Ibid. para. 1.
[101] WTO Doc. S/L/64, para. 2; see the interesting analysis by Panagiotis Delimatsis, 'Towards a Horizontal Necessity Test for Services, Completing the GATS Art. VI:4 Mandate' in Marion Panizzon, Nicole Pohl, and Pierre Sauvé, eds., *GATS and the Regulation in International Trade in Services* (Cambridge University Press, 2008), 370–96.
[102] WTO Doc. S/L/70, *Decision on Domestic Regulation*, Adopted by the Council for Trade in Services on 26 April 1999, 28 April 1999.

as required by paragraph 2 of the Decision on Disciplines Relating to the Accountancy Sector. . . .

4. The Working Party shall report to the Council with recommendations no later than the conclusion of the forthcoming round of services negotiations.

4.2.1.2 Provisional application of Article VI:4 principles

Pending the adoption of a regime by the CTS pursuant to GATT Article VI:4, WTO members will, in accordance with GATS Article VI:5(a), abstain from introducing measures which do not respect the *spirit* of GATS Article VI:4 in all sectors where they have undertaken specific commitments.

> In sectors in which a Member has undertaken specific commitments, . . . the Member shall not apply licensing and qualification requirements and technical standards that nullify or impair such specific commitments in a manner which:
>
> (i) does not comply with the criteria outlined in subparagraphs 4 (a), (b) or (c) and
>
> (ii) could not *reasonably have been expected* of that Member at the time the specific commitments in those sectors were made [emphasis added].

According to the Secretariat, paragraph 5 only applies where measures taken nullify or impair specific commitments. In a dispute settlement procedure, the party claiming that its rights are being nullified or impaired needs to show and eventually prove that this requirement has been met. The impact of the discipline is further weakened by indent (ii) which exempts measures which could not reasonably have been expected of a member at the time the specific commitments in the relevant sectors were made. Thus, at least all measures which were already in place in 1995 would seem to be exempt from the rule that the criteria of paragraph 4 would apply regardless of the success of the efforts prescribed in GATS Article VI:4.[103] It would be for the affected party to establish a prima facie case that a certain regulatory intervention was unexpected. Also, it is not clear what kind of information will have to be provided: Is the regulatory practice of the scheduling member a relevant criterion? Are new insights from the social sciences a relevant criterion? It should be recalled that the original promise was not to de-regulate. Because the burden of proof associated with GATS Article VI:5(a)(ii) seems so onerous, some authors consider that only new measures are captured by Article VI:5, and hence come to the conclusion that this Article has to be read as a standstill clause.[104]

4.2.2 Transparency

According to GATS Article III:3, WTO members must inform the CTS of all new laws, regulations, or administrative guidelines which significantly affect trade in services covered by their respective specific commitments under the GATS.

[103] WTO Doc. S/C/W/96, Council for Trade in Services, *Article VI:4 of the GATS: Disciplines on Domestic Regulation Applicable to all Services*, Note by the Secretariat, 1 March 1999.

[104] For further analysis cf. Markus Krajewski, 'Art. VI GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18.

4.2.3 *Monopolies*

GATS Article VIII:2 reads:

> Where a Member's monopoly supplier competes, either directly or through an affiliated company, in the supply of a service outside the scope of its monopoly rights and which is subject to that Member's specific commitments, the Member shall ensure that such a supplier does not abuse its monopoly position to act in its territory in a manner inconsistent with such commitments.

According to the Secretariat, 'Members are enjoined to prevent such suppliers, if these are also active in sectors that are beyond the scope of their monopoly rights and covered by specific commitments'.[105] If a new monopoly is established in a sector where market access was granted, the provisions of GATS Article XXI on modifications of schedules will apply.

4.2.4 *Payments and transfers*

GATS Article XI:1 prohibits measures affecting the transfer of capital and payments which are related to its market access and national treatment obligations.[106] However, this obligation is subject to the pre-existing rights and obligations pursuant to IMF law (GATS Article XI:2):

> Nothing in this Agreement shall affect the rights and obligations of the members of the International Monetary Fund under the Articles of Agreement of the Fund, including the use of exchange actions which are in conformity with the Articles of Agreement, provided that a Member shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions, except under Article XII or at the request of the Fund.

The Secretariat clarified that the obligation under GATS Article XI:1

> is subject to the provision that capital transactions are not restricted inconsistently with specific commitments, except under Art. XII or at the request of the Fund. Footnote 8 to Art. XVI further circumscribes Members' ability to restrict capital movements in sectors where they have undertaken specific commitments on cross-border trade and commercial presence.[107]

The function of GATS Article XI is summarized by the Panel report on *US—Gambling* as follows:

> Article XI plays a crucial role in securing the value of specific commitments undertaken by Members under the GATS. Indeed, the value of specific commitments on market access and national treatments would be seriously impaired if Members could

[105] WTO Secretariat, *A Handbook on the GATS Agreement* (Cambridge University Press, 2005) 15.

[106] See also Art. XXVIII(c)(iii); for an analysis of GATS Art. XI see Juan Marchetti, *The GATS and Capital Movements* (Mimeo, 2006).

[107] WTO Secretariat, *A Handbook on the GATS Agreement* (2005), n. 15.

restrict international transfers and payment for service transactions in scheduled sectors. In ensuring, *inter alia*, that services suppliers can receive payments due under services contracts covered by a Member's specific commitment, Article XI is an indispensable complement to GATS disciplines on market access and national treatment. At the same time, the Panel is of the view that Article XI does not deprive Members from regulating the use of financial instruments, such as credit cards, provided that these regulations are consistent with other relevant GATS provisions, in particular Article VI.[108]

4.3 Other obligations under negotiation: emergency safeguards and subsidies

4.3.1 Safeguards

As GATS law stands, there is no provision for safeguards comparable to GATT Article XIX and its elaboration in the Agreement on Safeguards (SG). The principal function of a safeguard mechanism in the GATS would be that of a 'safety valve'[109] which would allow members temporarily to protect their domestic service industries, if they were suffering serious damage as a consequence of related liberalization commitments.

However, WTO members are supposed to negotiate such a regime pursuant to GATS Article X.[110] At the time of writing, a working group (the so-called GATS Rules group) has been established to negotiate a generic safeguards clause. The negotiations have not yet yielded a commonly agreed text.[111] So far, discussions focus on two issues: on the one hand, the rationale for such a mechanism, and, on the other hand, what is necessary to include such a mechanism meaningfully into the

[108] *US—Gambling* (Panel), para. 6.442.

[109] See Rainer Grote, 'Art. X GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18 at 235.

[110] It reads:

1. There shall be multilateral negotiations on the question of emergency safeguard measures based on the principle of non-discrimination. The results of such negotiations shall enter into effect on a date not later than three years from the date of entry into force of the WTO Agreement.
2. In the period before the entry into effect of the results of the negotiations referred to in paragraph 1, any Member may, notwithstanding the provisions of paragraph 1 of Article XXI, notify the Council on Trade in Services of its intention to modify or withdraw a specific commitment after a period of one year from the date on which the commitment enters into force; provided that the Member shows cause to the Council that the modification or withdrawal cannot await the lapse of the three-year period provided for in paragraph 1 of Article XXI.
3. The provisions of paragraph 2 shall cease to apply three years after the date of entry into force of the WTO Agreement.

[111] It had been proposed—and agreed by members at the meeting of 22 June 2011—that the Secretariat would prepare a 'documentation guide' to assist members in taking stock of the wealth of information contained in members' submissions, Secretariat Notes, and meeting reports issued since 1995. The guide would simply indicate the documents and the paragraph numbers where key ESM-related concepts had been addressed. It would not attempt to summarize the substance on these issues contained in the submissions or in the reports of discussions. The purpose of this 'documentation guide' is that it will be referred back to in the discussions, and to assist in identifying any remaining gaps and determining possible areas for future attention; cf. WTO Doc. S/WPGR/M/75, Working Party on GATS Rules, Report of the Meeting Held on 28 September 2011, 4 October 2011.

GATS context, taking into account the Agreement's principles and structure.[112] Divergent positions arose from a lack of consensus over the following points:[113] Some have argued that there is no compelling need to negotiate safeguards, in the light of the fact that the GATS contains a series of in-built safeguards.[114] In fairness,[115] the GATS mostly consolidated the pre-1994 status quo, which had in many cases undergone significant liberalization during the Uruguay Round (1986–93). In other words, negotiators might have felt that, in light of the commitments made during the Uruguay Round, there was no urgency to establish safeguard rules. Conceivably, the need to negotiate safeguards will be greater when commitments will be more meaningful.[116] Unfortunately, that bridge has not yet been reached at the multilateral level, whereas significant services liberalizations take place at the bilateral level.

4.3.2 Subsidies

GATS Article XV recognizes the possibility that subsidies might have trade-distorting effects, and calls for WTO members to enter into negotiations with the objective of developing the necessary multilateral disciplines to avoid such trade-distortive effects. At the time of writing, the GATS Rules group has not yet reached a decision on the treatment of this practice.[117] GATS Article XV:2 allows WTO members which consider that they have been affected by trade-distorting subsidies of another member to request consultations. Such requests shall be accorded 'sympathetic consideration', which is nothing to be sneered at, but not something one may bank on. Should those consultations prove fruitless, the WTO member affected by subsidies has no legal remedies under the WTO Agreement to address the issue.[118]

[112] Juan Marchetti and Petros Mavroidis, 'What are the Main Challenges for the GATS Framework? Don't Talk about Revolution' (2004) *European Business Organization Law Review* 5, 511–62.

[113] Interesting analysis of the unresolved issues can be found in Rainer Grote, 'Art. X GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, Vol. 6, n. 18 at 235.

[114] Bernard Hoekman, 'Safeguard Provisions and International Agreements Involving Trade in Services' (1993) *The World Economy* 16, 29–49; Bernard Hoekman, 'Assessing the General Agreement on Trade in Services' in Will Martin and L. Alan Winters, eds., *The Uruguay Round and Developing Economies* (Cambridge University Press, 1996). For further references cf. Rainer Grote, 'Art. X GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, Vol. 6, n. 18 at 235 *et seq.*

[115] Compare Bernard Hoekman, 'Assessing the General Agreement on Trade in Services' in Will Martin and L. Alan Winters, eds., *The Uruguay Round and Developing Economies* (Cambridge University Press, 1996), n. 114; Pierre Sauvé and Robert Stern, *The GATS 2000: New Directions in Services Trade Liberalization* (Brookings, 2000), n. 5; Patrick Messerlin, *The Cost of Protectionism in Europe* (Washington D.C.: Institute of International Economics, 2001).

[116] Juan Marchetti and Petros Mavroidis, *Market Access, Discrimination and Regulatory Intervention under the GATS*, n. 12, take the view that political economy concerns drive the negotiations on GATS safeguards.

[117] WTO Doc. TN/S/38, Council for Trade in Services, Special Session, *Report by the Chairman of the Council for Trade in Services in Special Session*, 14 March 2014; see also WTO Doc. S/WPGR/M/86, Working Party on GATS Rules—Report of the meeting held on 18 March 2015—Note by the Secretariat. For an excellent overview of the state of play see Fernando Piérola, 'A Safeguards Regime for Services' in Marion Panizzon, Nicole Pohl, and Pierre Sauvé, eds., *GATS and the Regulation in International Trade in Services* (2008) 434–65.

[118] On the issue of whether subsidies should be covered by the national treatment obligation (GATS Art. XVII) see the discussion on GATS Art. XVII later in the chapter.

4.4 Institutional provisions

Article IV:2 of the WTO Agreement provides for the establishment of the CTS, which operates under the general guidance of the General Council. Its mandate, contained in GATS Article XXIV is broad:

> The Council for Trade in Services shall carry out functions as may be assigned to it to facilitate the operation of this Agreement and further its objectives. The Council may establish such subsidiary bodies as it considers appropriate for the effective discharge of its functions.

In this context, the CTS has established a series of subsidiary bodies which have dealt with, and are dealing with, sector-specific (telecommunications, financial services, etc.) or horizontal issues (a good example in this area being the Working Party on GATS Rules established by the Council in order to pursue the mandate laid down in GATS Article X).

5. Specific Commitments

5.1 Introduction: schedules of specific commitments

Whereas the GATT provides, in its Article XI, market access for *all* goods—restricted only through the right to charge tariffs—and national treatment (Article III:1, 4) once the product has lawfully crossed the border, the members were not prepared to go similarly far with regard to the heavily regulated product 'service'. Services only benefit from market access (pursuant to GATS Article XVI) and national treatment (pursuant to GATS Article XVII), if the pertinent service sector[119] is included in the schedule of specific commitments (the 'services schedule'). Only if a sector is scheduled in that way, the market access-restricting measures listed in GATS Article XVI:2, are prohibited, however, subject to having not been explicitly reserved in the pertinent column of the schedule.[120]

Hence, GATS Articles XVI, XVII, and XVIII (which allow WTO members to make any additional commitments they deem appropriate) define the scope of specific commitments, which, pursuant to GATS Article XX, will have to be inscribed in a transparent fashion in the schedule of a member:

> Each Member shall set out in a schedule the specific commitments it undertakes under Part III of this Agreement. With respect to sectors where such commitments are undertaken, each Schedule shall specify:

[119] cf. the definition in GATS Art. XXVIII(e).

[120] These prohibited, yet retainable, quantitative restrictions will further be discussed below; they include, inter alia, limitations on the number of service suppliers; limitations on the total value of service transactions or assets; limitations on the total number of service operations or on the total quantity of service output, limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ; measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

(a) terms, limitations and conditions on market access;
(b) conditions and qualifications on national treatment;
(c) undertakings relating to additional commitments;
(d) where appropriate the time-frame for implementation of such commitments; and
(e) the date of entry into force of such commitments.

This is the so-called 'positive list approach': Every WTO member has to communicate *erga omnes partes contractantes* in its schedule *both* the sectors for which it grants market access *and* the extent to which this is done, in particular by including 'terms, limitations and conditions' that may modify ('custom-tailor') the 'standard package' of market access. This 'individualized package' is to be described 'negatively' in the schedule ('unless otherwise specified'), pursuant to GATS Article XVI:2.

As a consequence, schedules of specific commitments determine, often in great and not always easy to decipher detail, under what conditions market access and national treatment commitments have been undertaken for which sector and which mode of supply. They contain legal obligations and establish corresponding rights.[121] Members remain free to apply a more liberal regime than that described in the schedules, but may not impose less favourable conditions than scheduled.[122]

Pursuant to GATS Article XX:3, the schedules of members shall be annexed to the GATS and become an integral part of GATS, subject, therefore, to the normal rules of treaty interpretation, as enshrined in the VCLT.[123]

> Accordingly, the task of ascertaining the meaning of a concession in a Schedule, like the task of interpreting any other treaty text, involves identifying the *common intention* of Members, and is to be achieved by following the customary rules of interpretation of public international law, codified in Articles 31 and 32 of the *Vienna Convention*.[124]

Thus, the content of the schedules is neither determined by the subjective intention of the scheduling state (as the United States found out much to its chagrin in the *US—Gambling* case), nor by any (reasonable or not so reasonable) expectations from an exporting state; rather, the common understanding of the parties, as expressed in the treaty text (and as interpreted by competent institutions, i.e. in the case of a dispute the DSB) determines the schedules' binding content.[125]

5.1.1 The scheduling modalities

As the multilateral negotiation of trade in services was a first on many different levels, the then GATT Secretariat (upon invitation by the Ministers of GATT contracting parties)[126]

[121] See for the situation in GATT *EC—Computer Equipment* (Appellate Body), para. 109.
[122] Nellie Munin, *Legal Guide to GATS* (Kluwer, 2010) 126.
[123] *US—Gambling* (Appellate Body), para. 160.
[124] Ibid. para. 159, drawing on *EC—Computer Equipment* (Appellate Body), para. 84.
[125] cf. the Preamble of GATS and GATS Art. XIX:1; cf. also the relevant GATT case law which clearly influenced that part of *US—Gambling: EC—Chicken Cuts* (Appellate Body), paras. 239 and 277 *et seq.*
[126] GATT Doc. MTN.TCN/7 (MIN) of 9 December 1988, Part II, para. 10.

prepared a 'Services Sectoral Classification List' (W/120),[127] which was largely based on the UN Provisional Central Product Classification (CPC).[128] The practical importance of document 'W/120' cannot be overestimated. It is, for example, the basis for the determination of suspension of concessions under DSU Article 22:3(f)(iii).

5.1.2 The 1993 and 2001 Scheduling Guidelines

The 1993 Scheduling Guidelines,[129] also prepared by the GATT Secretariat, recommend the general use of the Services Sectoral Classification List (W/120) in order to avoid uncertainty of rights and obligations:

> The legal nature of a schedule as well as the need to evaluate commitments, require the greatest possible degree of clarity in the description of each sector or sub-sector scheduled. In general, the classification of sectors . . . should be based on the Secretariat's revised Services Sectoral Classification List. Each sector contained in the Secretariat list is identified by the corresponding Central Product Classification (CPC) number. Where it is necessary to refine further a sectoral classification, this should be done on the basis of the CPC or other internationally recognized classification (e.g. Financial Services Annex). The most recent breakdown of the CPC, including explanatory notes for each sub-sector, is contained in the UN Provisional Central Product Classification. . . .
>
> If a Member wishes to use its own sub-sectoral classification or definitions, it should provide concordance with the CPC in the manner indicated . . . If this is not possible, it should give sufficiently detailed definitions to avoid any ambiguity as to the scope of the commitment.[130]

While paragraph 1 of the 1993 Scheduling Guidelines explicitly rejects any claim to being an authoritative legal interpretation of the GATS, they were used by all members to prepare their schedules pursuant to GATS Article XX, and thus constitute the schedules' 'grammar and syntax'.

[127] GATT Doc. MTN.GNS/W/120 of 10 July 1991 (W/120).

[128] As there are differences between W/120 and the CPC, the question arose as to which of the two documents will prevail in case of a conflict. In *Canada—Autos*, the Panel in its report formally took the view that in case of conflict, the CPC number prevails over the literal description of the sector in document W/120, para. 10.281. The Appellate Body at that point, did not have to pronounce on the issue of hierarchy between the CPC and the W/120 classification list. However, on the *EC—Bananas III* case, the Appellate Body used the CPC classification to decide the definition of 'wholesale trade services' and the application of that definition (*EC—Bananas III* (Appellate Body), paras. 224–6). This may indicate the importance that the Appellate Body gives to the CPC in resolving an issue arising from the services classification.

[129] GATT Doc. MTN.GNS/W/164, *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, Group of Negotiations on Services, 3 September 1993 and, GATT Doc. MTN.GNS/W/164 and GATT Doc. MTN.GNS/W/164/ Add, *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, Addendum, Group of Negotiations on Services, 30 November 1993. Note that whereas the corresponding to the CPC GATT-legal instrument is the HS, there is no corresponding (in the GATT context) instrument to the Scheduling Guidelines.

[130] GATT Doc. MTN.GNS/W/164, *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, Group of Negotiations on Services, 3 September 1993, para. 16.

The legal relevance of the 1993 (and 2001[131]) Scheduling Guidelines has been addressed by several Panels[132] and by the Appellate Body in *US—Gambling*. There, the Appellate Body rejected the Panel's argument that both the 1993 Scheduling Guidelines and the Services Sectoral Classification List (W/120) constituted context to be considered pursuant to VCLT Article 31 as an 'instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty' (VCLT Article 31:2(b)). Rather, the Appellate Body viewed them as supplementary means of interpretation, pursuant to VCLT Article 32.[133]

Interestingly, the Appellate Body did not base its rejection on the (original) authorship of the documents by the Secretariat,[134] but failed to see sufficient acceptance 'by [all] the other parties as an instrument related to the treaty' (VCLT Article 31:2(b)). This is somewhat surprising, given that the WTO Agreement, via DSU Article 22:3(f)(ii) specifically uses the Services Sectoral Classification List (W/120) as a definition for the purposes of enforcement measures, which would indicate that indeed *all* members had integrated Document W/120 in their expression to be bound by the WTO Agreement.[135] In a somewhat puzzling twist, the Appellate Body accepts the *Harmonized System* as context for GATT schedules pursuant to VCLT Article 31:2(a).[136]

Despite the somewhat lesser status that the Appellate Body was willing to grant both to the 1993 Scheduling Guidelines and the Services Sectoral Classification List (W/120), *US—Gambling* carefully considered these documents to determine what the content of the US schedule was and came to the conclusion that the United States had indeed included commitments on gambling services. Hence, regardless of their precise legal status, these documents are the benchmark used by both the Appellate Body and Panels to determine the content of schedules.[137]

On 23 March 2001, the WTO members adopted the successor document to the 1993 Scheduling Guidelines, the 2001 Scheduling Guidelines.[138] They contain no substantive change or deviation from the 1993 Scheduling Guidelines. Rather, they re-state the 1993 Scheduling Guidelines and add a few Annexes and an illustrative list of limitations to national treatment:

> 3. Since schedules, including footnotes, headnotes and attachments, are a record of legal commitments, nothing should appear in them which a Member does not intend to be legally binding. A schedule contains the following main types of information: a clear description of the sector or sub-sector committed, limitations to market access,

[131] 2001 Scheduling Guidelines, n. 25.
[132] *US—Gambling* (Panel), para. 6.77 *et seq.*; *Mexico—Telecoms* (Panel), para. 7.43.
[133] *US—Gambling* (Appellate Body), paras. 175, 177, and 197.
[134] Ibid. para. 175.
[135] See, for example, Frederico Ortino, 'Treaty Interpretation and the WTO Appellate Body in US—Gambling: A Critique' (2006) *Journal of International Economic Law* 117, 128 *et seq.*
[136] *EC—Chicken Cuts* (Appellate Body), para. 195 *et seq.*
[137] *US—Gambling* (Appellate Body), para. 206 *et seq.*; see also Eric Leroux, 'Eleven Years of GATS Case Law: What Have We Learned?' n. 5, 764.
[138] 2001 Scheduling Guidelines, n. 25.

limitations to national treatment, and additional commitments other than market access and national treatment. If a Member undertakes a commitment in a sector then it must indicate for each mode of supply that it binds in that sector:
- what limitations, if any, it maintains on market access;
- what limitations, if any, it maintains on national treatment; and
- what additional commitments, relating to measures affecting trade in services not subject to scheduling under Articles XVI and XVII, it may decide to undertake under Article XVIII.

4. Where commitments do not cover the entire national territory, the entry should describe the geographical scope of measures taken according to Article I:3(a)(i).

5. If attachments are used, clear reference should be made to the part of the schedules they refer to (i.e. definitions in the first column, market access commitments in the second column, national treatment commitments in the third column and additional commitments in the fourth column).

6. Exchange control restrictions are subject to the general disciplines of Articles XI (Payments and Transfers) and XII (Restrictions to Safeguard the Balance of Payments) of the GATS.

7. There is no requirement in the GATS to schedule a limitation to the effect that the cross-border movement of goods associated with the provision of a service may be subject to customs duties or other administrative charges. Such measures are subject to the disciplines of the GATT.

Note, that the 2001 Guidelines are a consensual decision of the members assembled in the Council on Trade in Services and thus directly attributable to the members, whereas the 1993 Schedules had never been adopted by the Council.

5.1.3 Structure of schedules

Following the Scheduling Guidelines, members' schedules consist of four columns (see Table 16.2):

1. Column 1 contains a (positive) description of a committed sector or sub-sector.
2. Column 2 contains the (negative) market access limitations that the member wishes to retain.
3. Column 3 contains the (negative) national treatment limitations that the member wishes to retain.
4. Column 4 contains a (positive) description of additional commitments.

For each sector inscribed in Column 1, members have to specify in Columns 2 and 3 their market access (MA) and national treatment (NT) limitations. This is the 'negative' element in the 'positive listing approach'. Members need to determine:

Table 16.2 Structure of Schedules

Sector or sub-sector	Limitations on market access	Limitations on national treatment	Additional commitments
I. HORIZONTAL COMMITMENTS			
	(1)	(1)	
	(2)	(2)	
	(3)	(3)	
	(4)	(4)	
II. SECTOR-SPECIFIC COMMITMENTS			
	(1)	(1)	
	(2)	(2)	
	(3)	(3)	
	(4)	(4)	

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Pres. of natural persons

1. for which modes of supply ((1), (2), (3), or (4), in the order of GATS Article I:2),
2. which levels of commitments they undertake. In this context, the following terminology applies:
   (a) 'None' indicates 'no limitations (full commitment)'.[139]
   (b) 'Unbound' indicates that the member remains essentially free to regulate as it deems appropriate. This indication amounts to the lowest possible level of commitments.
   (c) 'Other' means that the WTO member will introduce specific language to describe its commitment.

According to the terminology used in the 2001 Scheduling Guidelines, category (a) is known as full commitment;[140] whereas category (b) is labelled: no commitment.[141] Category (c) is called commitment with limitations.[142] In addition to these, the 2001 Scheduling Guidelines contain two more categories of commitments: no commitment technically feasible[143] and special cases.[144]

[139] This reading of the term 'none' has been confirmed by the Panel on *US—Gambling*, para. 6.279.

[140] 2001 Scheduling Guidelines, n. 25, paras. 42 and 43.

[141] Ibid. para. 46.

[142] Ibid. paras. 44 and 45.

[143] Ibid. para. 47; this category can, by and large, be discarded since, as the 2001 Scheduling Guidelines mention, in such cases WTO members will simply introduce the term 'unbound'. If the liberalization of the pertinent sector eventually becomes technically feasible, fresh negotiations may lead to new definitions of the level of commitment. Any other interpretation would run counter to the maxim *in dubio pro mitius*.

[144] Ibid. paras. 48, 49. The second category (special cases) is de facto (that is, in the scheduling practice of WTO members) merged with the category commitment with limitations. The following example cited in

Because of the positive list approach, service sectors not included in a member's schedule are not bound, and thus are solely subject to the disciplines prescribed in Part II of the GATS.[145]

As Table 16.3 shows, WTO members may enter both horizontal and sector-specific commitments:

Table 16.3 Sample Schedule of Commitments: Arcadia[146]

Sector or sub-sector	Limitations on market access	Limitations on national treatment	Additional commitments
I. HORIZONTAL COMMITMENTS			
ALL SECTORS INCLUDED IN THIS SCHEDULE	4) Unbound, other than for (a) temporary presence, as in intra-corporate transferees, of essential senior executives and specialists and (b) presence for up to 90 days of representatives of a service provider to negotiate sales of services.	3) Authorization is required for acquisition of land by foreigners.	
II. SECTOR-SPECIFIC COMMITMENTS			
4. DISTRIBUTION SERVICES	1) Unbound (except for mail order: none).	1) Unbound (except for mail order: none).	
C. Retailing services (CPC 631, 632)	2) None.	2) None.	
	3) Foreign equity participation limited to 51 per cent.	3) Investment grants are available only to companies controlled by Arcadian nationals.	
	4) Unbound, except as indicated in horizontal section.	4) Unbound.	

A horizontal commitment applies to trade in services in all scheduled services sectors unless otherwise specified. It is in effect a binding, either of a measure which constitutes a limitation on market access or national treatment or of a situation in which there are no such limitations. Where measures constituting limitations are referred to, the commitment should describe the measure concisely, indicating the elements which make it inconsistent with GATS Articles XVI or XVII. In order to avoid repetition, it is

the 2001 Scheduling Guidelines, para. 48, illustrates this point: 'It could be argued that a reservation for a residence requirement, a nationality condition or a commercial presence requirement under cross border trade amounts to an "unbound". However in some cases there is clearly an advantage in inscribing those requirements instead of the term "unbound" in that trading partners have the certainty that there are no other limitations with respect to the cross border mode (see also paragraph 14 on residency requirements and paragraph 12 on nationality requirements).'

[145] Martin Molinuevo, 'Art. XX GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18 at 451.

[146] WTO Secretariat, *A Handbook on the GATS Agreement* (2005) 19.

> desirable to enter these commitments in a separate section at the beginning of the schedule according to the four modes of supply. Such a section could be entitled: "Horizontal commitments applicable to sectors listed in the sectoral part of the schedule". Some horizontal measures may be specific to only one mode of supply:
>
> Example: Legislation may refer to foreign investment, formation of corporate structures or land acquisition regulations. Such measures affect above all commercial presence.
>
> Example: Legislation may stipulate requirements regarding entry, temporary stay and right to work of natural persons; the categories of natural persons covered by a particular offer may also be specified. Such measures affect above all the presence of natural persons.
>
> Other horizontal measures may affect more than one mode of supply:
>
> Example: Legislation may provide for tax measures which are contrary to national treatment and not covered by Article XIV(d). Such measures would normally affect the supply of services in several modes.[147]

Sector-specific commitments are defined by the 2001 Scheduling Guidelines as applying

> to trade in services in a particular sector. If in the context of such a commitment, a measure is maintained which is contrary to Articles XVI or XVII, it must be entered as a limitation in the appropriate column (either market access or national treatment) for the relevant sector and modes of supply; the entry should describe the measure concisely, indicating the elements which make it inconsistent with Articles XVI or XVII.[148]

5.1.4 Changes in specific commitments

Once commitments have been entered into, WTO members have to abide by them (GATS Article XVI:1, *pacta sunt servanda*). These legally binding undertakings may, however, be altered, either through negotiations or unilaterally.

5.1.4.1 Multilateral modification of schedules

GATS Article XIX calls for progressive liberalization of trade in services. As stated earlier, negotiations were supposed to start within five years from the entry into force of the WTO Agreement,[149] but only began some additional five years later.[150] So far, no tangible results have been achieved.[151]

[147] 2001 Scheduling Guidelines, n. 25, para. 36.
[148] Ibid. para. 39.
[149] cf. WTO Doc. S/L/93, Guidelines and Procedures for the Negotiations on Trade in Services, adopted by the Special Session of the Council for Trade in Services on 28 March 2001, 29 March 2001.
[150] WTO Doc. WT/MIN/(05)/DEC (22 December 2005), Ministerial Conference, Ministerial Declaration adopted 18 December 2005, Annex C, para. 7.
[151] But see WTO Doc. TN/S/36 (21 April 2011) Council for Trade in Services—Special Session, Negotiations on Trade in Services, Report by the Chairman to the Trade Negotiations Committee; see also WTO Doc. WT/L/941 (28 November 2014) General Council, Post-Bali Work, Decision of 27 November 2014, which restarted also negotiations on services.

5.1.4.2 Unilateral modification of schedules

GATS Article XXI is the parallel provision to GATT Article XXVIII. It states in its paragraph (a) that a member may modify or withdraw any commitment three years after the commitment became effective. Thus, it provides WTO members with the possibility of modifying the content of their specific commitments, or withdrawing a specific commitment altogether, upon granting of a compensation. Article XXI serves the purpose of allowing a WTO member to reduce the trade liberalizing effect of its prior commitment. As already mentioned, such changes, though, do require compensation. We summarize the procedure as follows:

1. When a WTO member wants to modify its schedule of commitments, it will have to notify the CTS of its intent to do so. In contrast to the parallel GATT procedure, the notifying member will have to negotiate not only with a select group of countries (those holding initial negotiating rights and those having a substantial interest in the modifying member's market), but with any affected WTO member. This means that negotiations will by definition be multilateral.
2. Compensation has to be offered to all affected WTO members on an MFN basis. If there is disagreement as to the amount of compensation, the matter has to be referred to arbitration. Any affected member that wishes to enforce a compensation right must participate in the arbitration. Commitments may not be modified until compensatory adjustments in conformity with the findings of the arbitration have been made.
3. Where an arbitration has taken place and the modifying member has implemented the proposed modification without first complying with the arbitration findings, any affected member that participated in the arbitration can retaliate.

5.2 Market access under the GATS

5.2.1 Introduction

The Preamble of the GATS explicitly recognizes the right of its members

> to regulate . . . on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right[.]

This reflects both the wish of members to re-state for the record that the GATS contains no principled *obligation* to engage in further liberalization and also the fact that services are even more regulated than goods. This happens for very different reasons, most of them plausible and legitimate, some protectionist and of highly selective effect. In practice, abstaining from liberalization (or retreating from it), is supported by an amalgam of motivations: while it is a fact that those who wield political

power often have family members working in law and medicine, high standards for admittance to those professions not only ensure a high minimum standard for clients and patients, but also keep foreign competition out of the market. Also, in many countries, pharmacists, doctors, and other liberal professions can open new offices or shops (initially) only in under-served parts of the national territory. The declared goal is to ensure that these parts of the territory are sufficiently equipped with doctors, pharmacists, etc.; that it may protect the economic interests of the well-connected incumbents in the attractive metropolitan areas is not necessarily a contradiction. Food production and preparation (in shops and restaurants) are often subject to stringent health and safety disciplines, but may render market entry more difficult. Most countries require from bank managers certain qualifications and professional experience and a not insignificant minimal capital requirement; such requirements may make market entry quite difficult. Once that has been achieved, the newly registered financial institution may face tough new regulations, possibly prohibiting the sale of those financial products where the new market participant has a competitive edge.

Pursuant to the jurisprudence of the Panels, GATS Article XVI does not address *all* barriers to market entry, but only those listed in GATS Article XVI:2. A first reading of the catalogue in that provision reveals that it is targeting market access-restricting measures of a quantitative type,[152] regardless of whether they are discriminatory or origin-neutral.[153] As a consequence, minimum qualitative requirements and non-quantitative restrictions would fall outside the scope of GATS' market access provision, and be captured by GATS' domestic regulation disciplines in GATS Article VI.[154] GATS Article XVI:1 reads as follows:

> 1. With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.[155]

[152] Eric Leroux, 'Eleven Years of GATS Case Law: What Have We Learned?' n. 5 at 767: see also Joost Pauwelyn, '"*Rien ne va plus?*" Distinguishing Domestic Regulation from Market Access in GATT and GATS' (2005) *World Trade Review* 2, 131, esp. 153 *et seq.*

[153] cf. GATS Art. XX:2.

[154] Which reads in relevant parts:

1. In sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner.
2. (a) Each Member shall maintain or institute as soon as practicable judicial, arbitral or administrative tribunals or procedures which provide, at the request of an affected service supplier, for the prompt review of, and where justified, appropriate remedies for, administrative decisions affecting trade in services. Where such procedures are not independent of the agency entrusted with the administrative decision concerned, the Member shall ensure that the procedures in fact provide for an objective and impartial review . . .
3. Where authorization is required for the supply of a service on which a specific commitment has been made, the competent authorities of a Member shall, within a reasonable period of time after the submission of an application considered complete under domestic laws and regulations, inform the applicant of the decision concerning the application . . .

[155] Footnote in the original omitted.

Pursuant to GATS Article XVI:1, schedules are binding and create a floor or 'minimum standard' for the treatment of foreign services and service providers. However, the obligation to treat foreign services and service providers no less favourably than provided for in the schedule is qualified by reference to the limitations and conditions agreed to and specified in the schedule itself. If no specification to the contrary or conditions are attached, a number of measures are excluded, once the sectors are bound, pursuant to GATS Article XVI:2. GATS Article XVI:2 thus defines the *normal* (and normatively desirable) state of play, once market access has been granted, in that it declares certain quantitative restrictions as being not compatible with a market access commitment. However, it also allows the listed trade impediments to stay in force, provided the member has 'registered' them by reserving the right to keep them in its schedule. To this effect, WTO members will have to *indicate* in their schedule of commitments the subjectively appropriate limitation mentioned in subparagraphs (a) to (f). Limitations and restrictions stated in GATS Article XVI:2 can be entered with respect to each mode of supply.

5.2.2 Relationship between Article XVI:1 and Article XVI:2

In *US—Gambling*, the Panel undertook to examine whether Article XVI:2 exhaustively defines the types of restrictions that are prohibited by Article XVI. It came to the conclusion that

> the types of measures listed in the second paragraph exhaust the types of market access restrictions *prohibited* by Article XVI, in particular by the first paragraph of Article XVI. Paragraph 4 of the 1993 Scheduling Guidelines . . . confirms that paragraph 2 of Article XVI exhaustively defines the limitations and measures that are prohibited by Article XVI, unless scheduled. In that sense, paragraph 2 of Article XVI complements the first paragraph of that Article.[156]
>
> The ordinary meaning of the words, the context of Article XVI, as well as the object and purpose of the GATS confirm that the restrictions on market access that are covered by Article XVI are only those listed in paragraph 2 of this Article . . .[157]

Note that in *Mexico—Telecoms*, the Panel was of a different view. It found that a Mexican-

> scheduled requirement that commercial agencies obtain permits, and that these permits be based on regulations, is a temporal limitation that is not a market access limitation within the meaning of Article XVI:2(a) [Footnote omitted].
>
> Since we have found that Mexico's entry in the market access column of its schedule for services supplied by commercial agencies through commercial presence is not a market access limitation, we now need to determine what meaning it does have.[158]

By not adhering to its commitment, Mexico had—in the Panel's view—violated its obligations under GATS Article XVI:1 through a measure not captured by Article

[156] *US—Gambling* (Panel), para. 6.298. [157] Ibid. para. 6.318.
[158] *Mexico—Telecoms* (Panel), paras. 7.362 and 7.363.

XVI:2.[159] In *US—Gambling*, the Appellate Body chose on appeal to invoke judicial economy so as to not express its position on the matter. The more recent *China—Publications and Audiovisual Products* Panel confirms the *US—Gambling* Panel's view.[160] This, of course, was in line with what the Scheduling Guidelines had indicated:

> A Member grants *full market access* in a given sector and mode of supply when it does not maintain in that sector and mode of supply any of the types of measures listed in Art. XVI . . . The list is exhaustive and includes measures which may also be discriminatory according to the national treatment standard (Art. XVII) . . .[161]

It was on the basis of that interpretation—which we have criticized in the second edition of this textbook[162]—that members had understood the scope of GATS Article XVI, prepared their positions in the negotiations, and, finally, drafted their schedules.[163]

5.2.3 Forms of quantitative limitations

Once the member concerned has entered into a market access commitment, GATS Article XVI:2 prohibits

[159] Ibid. paras. 7.363–7.371; also ibid. fn. 1044: 'The Addendum to the Explanatory Note on Scheduling of initial commitments on Trade in Services (MTN.GNS/W/164/Add.1, 30 November 1993, corroborates this finding: "The requirement to obtain an approval or a licence is not in itself a trade restriction and therefore does not need to be scheduled. However, if the criteria for granting licenses or approval contain a market access restriction (e.g. economic needs test) or discriminatory treatment, the relevant measures would need to be scheduled if a Member wishes to maintain them as limitations under Article XVI or XVII. It has been pointed out that in some offers the granting of licences is subject to review, meaning they are granted on a discretionary basis. In such a case the right to supply the service is unbound."'

[160] *China—Publications and Audiovisual Products* (Panel), para. 7.1353.

[161] GATT Doc. MTN.GNS/W/164, Scheduling of Initial Commitments in Trade in Services: Explanatory Note, Group of Negotiations on Services, 3 September 1993, para. 4.

[162] This is what we said in the second edition: 'This interpretation is wrong, for a number of reasons: *first*, because the wording of Art. XVI:1 GATS, that is, the immediate context to Art. XVI:2 GATS, mentions not only *limitations* (which are specified in Art. XVI:2 GATS), but also *terms* and *conditions*, as the three elements, that can be used in order to regulate the opening of a particular market to foreign competition. The reading of Art. XVI GATS by this Panel effectively defines *terms* and *conditions*. This is however, contrary to the VCLT, in the name of which this and all other WTO Panels have performed their interpretative tasks (*ut legis valeat quaem paereat*). *Second*, footnote 8 to the GATS provides support to the argument that the list of Art. XVI:2 GATS is not exhaustive. According to this footnote, a WTO Member making commitments under *Mode 1*, cannot restrict capital movement (to and from its territory) necessary to realize cross border supply of the service at hand; further to this footnote, a WTO Member making commitments under *Mode 3*, cannot restrict capital movement (to its territory) necessary to realize commercial presence in its market. A literal reading of this footnote supports the view that, when making commitments under *Modes 2* and *4*, WTO Members can, of course, restrict capital movement. The restriction of capital movement however, is not listed in Art. XVI:2 GATS. Hence, the list of Art. XVI:2 GATS cannot be considered exhaustive.'

[163] See on this issue also Panagiotis Delimatsis and Martin Molinuevo, 'Art. XVI GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18, 111, with further references; Eric Leroux, 'From Periodicals to Gambling: A Review of Systemic Issues Addressed by WTO Adjudicatory Bodies under the GATS' in Marion Panizzon, Nicole Pohl, and Pierre Sauvé, eds., *GATS and the Regulation in International Trade in Services* (2008) 111; Erich Vranes, 'The WTO and Regulatory Freedom: WTO Disciplines on Market Access, Non-Discrimination and Domestic Regulation Relating to Trade in Goods and Services' (2009) *Journal of International Economic Law* 12, 953–87.

(1) certain quantitative restrictions (subparagraphs a–d),
(2) limitation on the form of legal entity (subparagraph e), and
(3) foreign equity participation (subparagraph f),

unless specified otherwise in the schedules. Each subparagraph describes limitations on the free trade in services which are prohibited as a matter of principle. However, they may nevertheless be included in the schedules. If that option is used, their use becomes WTO-compatible: for instance, limitations on the number of service suppliers are, as a matter of principle, excluded for schedules services. However, if such limitation is specifically included in the pertinent schedule, the use of that trade restriction is in line with GATS Article XVI:2. The latter provision also indicates the possible formats that these limitations may take (for instance 'in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test').

The latter format is not further defined in the GATS. According to the 'economic needs test', quantitative limits are not expressed in (transparent) numbers, but are determined by state bodies' or industry associations'[164] view on what is economically beneficial. Authorities may use the test to apply a quota that can be modified periodically or to decide any application on a case-by-case basis.[165]

The 2001 Guidelines[166] provide several examples of market access limitations in order to assist members in the task of scheduling commitments. Some of the possible market access limitations mentioned are:

(a) Limitations on the number of service suppliers: For example, licences for new restaurants subject to an economic needs test based on population density; annually established quotas for foreign medical practitioners;
(b) Limitations on the total value of service transactions or assets: For example, foreign bank subsidiaries limited to x per cent of total domestic assets of all banks;
(c) Limitations on the total number of service operations or on the total quantity of service output: For example, restrictions on the broadcasting time available for foreign films;
(d) Limitations on the total number of natural persons: For example, foreign labour should not exceed x per cent of the workforce and/or not account for more than y per cent of total wages;
(e) Restrictions or requirements regarding types of legal entity or joint venture: For example, commercial presence excludes representative offices; foreign companies are required to establish subsidiaries;
(f) Limitations on the participation of foreign capital: For example, foreign equity participation in domestic insurance companies should not exceed x per cent of commercial presence.[167]

[164] Upon delegation by the state.
[165] cf. Juan Marchetti and Petros Mavroidis, 'What are the Main Challenges for the GATS Framework? Don't Talk about Revolution', n. 112, 511–62.
[166] 2001 Scheduling Guidelines, n. 25.
[167] Ibid. para. 12.

The 2001 Scheduling Guidelines also include the following passages on the scheduling task of Article XVI limitations:

> The quantitative restrictions can be expressed numerically, or through the criteria specified in sub-paragraphs (a) to (d); these criteria do not relate to the quality of the service supplied, or to the ability of the supplier to supply the service (i.e. technical standards or qualification of the supplier).
>
> With regard to market access limitations, such as numerical ceilings or economic needs tests, the entry should describe each measure concisely indicating the elements which make it inconsistent with Article XVI. . . .
>
> Approval procedures or licensing and qualification requirements, such as financial soundness or membership in a professional organization, are frequently stipulated as conditions to obtain a license. If they are of a non-discriminatory nature, and therefore to be applied equally to nationals and foreigners, they should not be scheduled under Article XVII. Nor should they be scheduled under Article XVI as long as they do not contain any of the limitations specified in Article XVI: However, if such approval procedures or licensing and qualification requirements are discriminatory, they should be scheduled as national treatment limitations. If approval procedures or licensing and qualification requirements contain any of the limitations specified in Article XVI, they should be scheduled as market access limitations. It has been pointed out that in some schedules the granting of licenses has been subject to review, possibly meaning they are granted on a discretionary basis. In such a case the right to supply the service is uncertain. Therefore such entries should be avoided unless the objective criteria on which such a review is based are precisely described. . . .
>
> Minimum requirements such as those common to licensing criteria (e.g. minimum capital requirements for the establishment of a corporate entity) do not fall within the scope of Article XVI: If such a measure is discriminatory within the meaning of Article XVII and, if it cannot be justified as an exception, it should be scheduled as a limitation on national treatment. If such a measure is non-discriminatory, it is subject to the disciplines of Article VI:5. Where such a measure does not conform to these disciplines, and if it cannot be justified as an exception, it must be brought into conformity with Article VI:5 and cannot be scheduled.[168]

5.2.4 Relationship with the national treatment obligation

According to GATS Article XX:2,

> [m]easures inconsistent with both Articles XVI and XVII shall be inscribed in the column relating to Article XVI. In this case the inscription will be considered to provide a condition or qualification to Article XVII as well.

[168] Ibid. paras. 8–11.

GATS Article XX assumes that partial overlaps between Article XVI and Article XVII are possible, without, however, providing any guidance on how such overlap is to be determined and what consequences it should entail.

GATS Article XVI:2 (market access) contains a comprehensive list of restrictive measures which a member shall not maintain with regard to a service sector for which it has granted unqualified market access. However, the member has the right to maintain such measures, if they are scheduled properly regardless of whether they are discriminatory (within the meaning of national treatment) or non-discriminatory.[169] Some measures—such as the requirement of specific types of joint ventures through which the service supplier may supply a service (Article XVI:2(e)) and measures relating to foreign equity participation (Article XVI:2(f))—are per se discriminatory, as they can only be imposed on foreign service suppliers.

According to Article XVII (which we shall discuss in the next section), members grant full national treatment in a given sector by according conditions of competition no less favourable than those accorded to their own like services and service suppliers. Other than Article XVI, Article XVII does not provide a list of measures constituting limitations of its respective coverage.

As a consequence, the exact relationship between these two norms is the subject of an intensive debate in the GATS. In 2004, the CTS summarized the possible approaches to the issue:[170]

> Conceptually, five types of approaches are conceivable to allocate measures falling under the overlap to either Article XVI or Article XVII. These approaches are sketched out under points 1–5 below.
>
> **1. The area of the overlap would be allocated to the Market Access Column**
> One way could be to state clearly that all measures referred to under paragraph 2(a)–(f) of Article XVI would fall exclusively under the scope of that Article, and that they would be excluded—even in their discriminatory form—from the scope of Article XVII. In other words, Article XVI would become the *lex specialis* for these measures.
>
> - *Example: Under the situation of an Unbound in Market access and a None in National Treatment, any of the six types of limitations could be introduced, regardless of whether in non-discriminatory or discriminatory form. In the inverse situation where a commitment existed in the Market Access column, with an Unbound in the national treatment column, the Member would not be permitted to introduce any discriminatory market access type measures. The suggestions made by Brazil in JOB (02)/215) would produce this result.*

[169] Which is clearly stated in the Scheduling Guidelines (WTO Doc. S/L/92, Trade in Services, Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), adopted by the Council for Trade in Services on 23 March 2001, 28 March 2001) at para. 8, and thus may be understood as the common language and grammar (to paraphrase the Appellate Body in *EC—Chicken Cuts*) of scheduling negotiations.

[170] WTO Doc. S/C/W/237, CTS, Consideration of Issues Relating to Article XX:2 of the GATS, Report by the Chairman of the Committee on Specific Commitments, 24 March 2004.

2. The area of the overlap would be allocated to the National Treatment Column
Under this option, it would be made explicit that Article XVI covers the types of measures listed in paragraph 2(a)–(f) only in their non-discriminatory form. Any of those measures taken in their discriminatory form, would fall within the scope of Article XVII. Under such a solution, however, it would be necessary to exclude from the scope of Article XVI those measures referred to in subparagraphs (e) and (f) which could only be applied in a discriminatory form, such as joint-venture requirements and limitations on foreign share-holding.

- *Example: In case of an Unbound in market access and a commitment in national treatment, the Member would only be permitted to take market access measures in their non-discriminatory form. If the Unbound existed in the national treatment column, with a None under market access, the Member would be free to introduce any discriminatory measure, including any of those measures mentioned in Article XVI:2 (a–f) in their discriminatory form.*

3. The *Unbound* entry prevails over the entry containing the commitment
Under the third and fourth approaches, the overlap would be allocated according to entries in the schedule rather than by looking at the column in which the entries have occurred. Under the third approach, an *Unbound* entry in either the market access column or the national treatment column would permit a Member to introduce discriminatory measures falling under the overlap regardless of the entry in the respective other column.

- *Example: An Unbound in the market access column with a commitment in national treatment would allow the Member to apply any discriminatory market access limitation. We would obtain the same result as concerns the overlap area in the inverse situation: also an Unbound in national treatment together with a None in the market access column would permit the Member to apply any discriminatory measure, including those falling under Article XVI:2.*

4. The entry containing the commitment prevails over the *Unbound*
This option would allocate the overlap in the opposite way as in the third approach. The column containing the commitment would prevail insofar as the measures falling under the overlap could not be maintained or introduced if not specifically scheduled in either the market access or national treatment columns.

- *Example: Under this situation, a commitment in the national treatment column, together with an Unbound under market access would allow the Member only to operate measures falling under market access in its non-discriminatory form. In the reverse case, i.e. a commitment under market access, and an Unbound under national treatment, the Member could operate market access measures only to the extent scheduled. The suggestions made by Switzerland in JOB (03)/85 would produce this result.*

5. Avoiding instances of the overlap in schedules of specific commitments
Another possible approach, albeit not of a general nature, would be to seek to avoid instances of the overlap in the schedules by introducing clarifying text as to the intended scope of the commitments. Elements of such a 'schedule-based' approach

have been outlined by Hong Kong, China.[171] Under this approach, the 'issue' would not disappear, but cases giving rise to the issue would be reduced.

- *Example: If a Member wished to schedule a situation of an Unbound in market access and a commitment in national treatment, the Member would clarify in its schedule whether the area of overlap would be covered by the Unbound, or by the commitment. If the members wished to maintain a free hand with regard to discriminatory Article XVI-type measures, he could clarify this, for example, by inscribing under national treatment 'None, except for discriminatory measures falling under Article XVI:2.' Conversely, if the Member wanted to allocate the area of overlap to the area covered by the commitment, he could enter under market access 'Unbound', except for measures falling also under Article XVII. Similar clarifications could be conceived of for the situation where a Member wished to inscribe None in the market access column, and Unbound in the national treatment column.*[172]

Not surprisingly, the matter is subject to a lively scholarly debate.[173] One part of the literature views Article XVI as a specific manifestation, a sub-set of the national treatment obligation. In this view, GATS Article XVI covers only discriminatory market access restrictions, and thus affects measures which are prohibited once the member concerned has submitted a sector to the full application of the national treatment obligation. A second view suggests that discriminatory market access provisions, such as regulations prescribing joint ventures (Article XVI:2(e)) or limitations on foreign capital or shareholders (Art. XVI:2(f)) would also have to comply with the demands of Article XVII, despite the pertinent application of Article XVI. Lastly, some perceive Article XVI as a *lex specialis* to Article XVII: All measures covered by Article XVI would be subject to the special regime of the GATS' market access provision, regardless of whether they are discriminatory or non-discriminatory. All discriminatory measures would be covered by GATS Article XVII, except those already addressed by Article XVI.

5.2.5 GATS Articles XVI and VI

In its report in *US—Gambling*, the Panel opined that 'Articles VI:4 and VI:5 on the one hand and XVI on the other hand are mutually exclusive',[174] due to the fact that

> [u]nder Article VI and Article XVI, measures are either of the type covered by the disciplines of Article XVI or are domestic regulations relating to qualification

[171] [Footnote 11 in the original] See JOB (03)/34, paras. 11–13.

[172] WTO Doc. S/C/W/237, CTS, *Consideration of Issues Relating to Article XX:2 of the GATS*, Report by the Chairman of the Committee on Specific Commitments, 24 March 2004, paras. 15–20.

[173] See, for example, Petros Mavroidis, 'Highway XVI Re-visited: The Road from Non-Discrimination to Market Access in GATS' (2007) *World Trade Review* 6, 1–23; for different opinions see, for example, Aaditya Mattoo, 'National Treatment in the GATS. Corner-Stone or Pandora's Box?' (1997) *Journal of World Trade* 31, 107, 116–17; Martin Molinuevo, 'Art. XX GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18 at 445–65; Markus Krajewski and Maika Engelke, 'Art. XVII GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18 at 416–19; Panagiotis Delimatsis, 'Don't Gamble with the GATS—The Interaction between Arts. VI, XVI, XVII and XVIII in the Light of the Gambling Case' (2006) *Journal of World Trade* 40, 1059, 1074.

[174] *US—Gambling* (Panel), para. 6.305.

requirements and procedures, technical standards and licensing requirements subject to the specific provisions of Article VI.[175]

This view is reminiscent of the mutually exclusive relationship between border measures (for example, GATT Articles II, XI) and internal measures (for example, GATT Article III) with regard to goods. However, a state measure that is intended to define domestic regulations relating to qualification requirements and procedures, technical standards and licensing requirements may contain elements regulated by GATS Article XVI.

If approval procedures or licensing and qualification requirements contain any of the limitations specified in Article XVI, they should be scheduled as market access limitations.[176]

According to that view, measures covered in principle by GATS Article VI may also be subject to GATS Article XVI.

However, Panels have adopted a narrow construction of the terms appearing in GATS Article XVI. In *US—Gambling*, the Panel dealt, inter alia, with the US state rules establishing that a person who engaging in gambling committed a 'class 1 petty offense', whereas a person 'who engages in professional gambling commits a class 1 misdemeanor'. If the gambler was 'a repeating gambling offender, it is a class 5 felony'.[177]

Irrespective of the repercussions of this law for international transactions, the Panel found that it was *not* inconsistent with GATS Article XVI, since it was

not directed at "service suppliers" for the purpose of Article XVI:2(a) nor to "service operations" and "service output" for the purposes of Article XVI:2(c).... Antigua has not adduced any evidence to indicate that the *supply* of gambling services by the Internet or by any other means included in mode 1 is prohibited.[178]

Undeniably, this law resulted in a limitation of the supply of remote gambling, and maybe even in a 'zero quota' for some services.[179] One may question whether, through such laws, WTO members might effectively be circumventing their commitments (for which, based on reciprocity, a price in terms of trade liberalization has been paid by other WTO members). Indeed, the purpose of GATS Article XVI:2 and its a priori prohibitions could be deprived of any meaningful content, thus violating the efficiency principle according to which a treaty should be interpreted in a way that ensures that each of its provisions have a meaning. A market access commitment implies that the market may be accessed legally (in the case at hand, technologically

[175] Ibid.

[176] 2001 Scheduling Guidelines, n. 25, para. 10.

[177] Colorado Revised Statutes, paras. 18-10-103, cited in *US—Gambling* (Panel), para. 6.381.

[178] *US—Gambling* (Panel), para. 6.382, see also paras. 6.397, 6.401, and 6.405 which reflect similar findings.

[179] cf. 1993 Scheduling Guidelines (GATT Doc. MTN.GNS/W/164, Scheduling of Initial Commitments in Trade in Services: Explanatory Note, Group of Negotiations on Services, 3 September 1993), para. 6; 2001 Scheduling Guidelines (WTO Doc. S/L/92, Trade in Services, Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), adopted by the Council for Trade in Services on 23 March 2001, 28 March 2001), para. 12.

and factually possible access came with a prison sentence attached to it). Panels will often be walking a tightrope when facing such issues. The task for adjudicative bodies in this context is to determine whether the state measures that result in effects reminiscent of Article XVI:2 measures have a legitimate and non-protectionist policy purpose that does not a priori run counter to the trade liberalizing purpose of GATS Article XVI.

5.2.6 GATS Articles XVI and XIV

The chapeau of GATS Article XIV ('*nothing* in this Agreement shall be construed to prevent the adoption of enforcement by any Member of measures')[180] makes it obvious that GATS Article XIV can serve as a justification for violations of GATS Article XVI. The Panel and the Appellate Body confirmed this view in *US—Gambling*.[181]

5.3 National Treatment

5.3.1 Introduction

Once a national treatment commitment has been entered into, members are obliged not to apply discriminatory measures benefiting domestic services or service suppliers. The key requirement is to not modify, in law or in fact, the conditions of competition in favour of the member's own service industry.[182] Article XVII reads as follows:

1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers [footnote omitted].
2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.
3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

As in GATT, the function of the national treatment obligation is to 'ensure equal competitive opportunities for like services of other Members'.[183] According to the 2001 Scheduling Guidelines,

[180] Emphasis added.
[181] *US—Gambling* (Panel), para. 6.454.
[182] The General Agreement on Trade in Services (GATS): objectives, coverage and disciplines, available at <http://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm>.
[183] *China—Electronic Payment Services* (Panel), para. 7.700.

> [a] Member grants full national treatment in a given sector and mode of supply when it accords in that sector and mode conditions of competition no less favourable to services and service suppliers of another Member than those accorded to its own like service and service suppliers. The national treatment standard does not require formally identical treatment of domestic and foreign suppliers; formally different measures can result in effective equality of treatment; conversely, formally identical measures can in some cases result in less favourable treatment of foreign suppliers (*de facto* discrimination). Thus, it should be borne in mind that limitations on national treatment cover both, *de facto* and *de jure* discriminations[.][184]

The Guidelines add that

> [t]here is no obligation in the GATS which requires a Member to take measures outside its territorial jurisdiction. It therefore follows that the national treatment obligation . . . does not require a Member to extend such treatment to a service supplier located on the territory of another Member.[185]

Unlike GATS Article XVI, GATS Article XVII does not contain an exhaustive list of the types of measure which would constitute limitations on national treatment. The 2001 Scheduling Guidelines provide the following examples of scheduling national treatment limitations to illustrate how GATS Article XVII should work:

> (a) Domestic suppliers of audiovisual services are given preference in the allocation of frequencies for transmission within the national territory. (Such a measure discriminates explicitly on the basis of the origin of the service supplier and thus constitutes formal or *de jure* denial of national treatment.)
>
> (b) A measure stipulates that prior residency is required for the issuing of a license to supply a service. (Although the measure does not formally distinguish service suppliers on the basis of national origin, it *de facto* offers less favourable treatment to foreign service suppliers because they are less likely to be able to meet a prior residency requirement than like service suppliers of national origin.)[186]

Regarding the need to schedule residency requirements, it should be decided on a case-by-case basis, and in relation to the activity concerned, which requirements (for example, the need to reside in the country as opposed to having a mailing address in the country) constitute a de facto national treatment restriction and therefore must be scheduled under Article XVII unless justifiable as an exception. If the residency requirement is not discriminatory, it would be subject to the disciplines of Article VI:5. If it is not consistent with these disciplines and if it cannot be justified as an exception,

[184] 2001 Scheduling Guidelines, n. 25, at para. 13.

[185] Ibid. para. 15; see also Juan Marchetti and Petros Mavroidis, *Market Access, Discrimination and Regulatory Intervention under the GATS* (2006).

[186] 2001 Scheduling Guidelines, n. 25, para. 13.

it must be brought into conformity with Article VI:5.[187] Other examples for discriminatory measures would be discriminatory subsidies and other fiscal measures; discriminatory requirements with regard to licensing, registration, qualification, or training; technology transfer requirements; prohibitions regarding real estate ownership; local content requirements; and discriminating capital requirements.[188]

5.3.2 *The test for establishing a violation of NT*

In *EC—Bananas III*,[189] the Panel developed a three-pronged test to establish inconsistency of a particular measure with GATS Article XVII; on appeal, the Appellate Body followed the same approach.[190] Not surprisingly, it is reminiscent of the tests applied for analysing GATT Article III and Article 2.1 of the Agreement on Technical Barriers to Trade (TBT). In the case at hand, the claim was that the European Community had been in violation of its obligations under the GATS because it was treating EC distributors of bananas more favourably than their foreign counterparts.

In the Panel's view, in order to establish a breach of the national treatment obligation of GATS Article XVII the following three elements have to be demonstrated: (1) undertaking of a commitment in a relevant sector and mode of supply by a member; (2) adoption or application by that member of a measure affecting the supply of services in that sector and/or mode of supply; and (3) the measure accords to like foreign services suppliers or like foreign services treatment less favourable than that it accords to domestic service suppliers or services.[191]

5.3.2.1 Specific commitments must have been undertaken

Whether specific commitments must have been undertaken is a factual issue, dependent on the content of the schedule of concessions of a WTO member. Clearly, the interpretation may be contentious. In *China—Publications and Audiovisual Products*, the Panel found that the context provided by China's inscriptions in the 'Audiovisual Services' sector of its GATS schedule allowed the conclusion that the entry on 'Sound recording distribution services' extended to the distribution of content through electronic means.[192] According to the Panel, it was 'reasonable to presume that the coverage of the entries in China's Schedule under "Audiovisual Services" should extend to the distribution in *non-physical* form of audiovisual products'.[193] The Appellate Body agreed:

[187] cf. WTO Doc. S/L/92, Trade in Services, Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), adopted by the Council for Trade in Services on 23 March 2001, 28 March 2001 at para. 14: 'Regarding the need to schedule residency requirement, it should be decided on a case-by-case basis and in relation to the activity concerned'.

[188] See also ibid. Attachment 1.

[189] *EC—Bananas III* (Panel), paras. 7.314, 7.357, and 7.375.

[190] *EC—Bananas III* (Appellate Body), para. 241 *et seq.* and esp. para. 244.

[191] *EC—Bananas III* (Panel), para. 7.314.

[192] *China—Publications and Audiovisual Products* (Panel), para. 7.1203.

[193] Ibid. para. 7.1205.

> [T]he terms used in China's GATS Schedule ("sound recording" and "distribution") are sufficiently generic that what they apply to may change over time....
>
> We further note that interpreting the terms of GATS specific commitments based on the notion that the ordinary meaning to be attributed to those terms can only be the meaning that they had at the time the Schedule was concluded would mean that very similar or identically worded commitments could be given different meanings, content, and coverage depending on the date of their adoption or the date of a Member's accession to the treaty. Such interpretation would undermine the predictability, security, and clarity of GATS specific commitments, which are undertaken through successive rounds of negotiations, and which must be interpreted in accordance with customary rules of interpretation of public international law.[194]

5.3.2.2 Measure affecting trade in services

In *EC—Bananas III*,[195] the Appellate Body interpreted the term 'affecting trade in services' broadly; it pointed out that the ordinary meaning of the word 'affecting' reflected the intent to give a broad reach to the GATS.[196] The Appellate Body specified in a later report that Panels had to take all factual aspects of the deliverance of a given service into account: for instance, Panels have to consider *who* provides the service concerned and *how* such services are supplied in order to determine that the measure '*affects*' trade in services.[197]

5.3.2.3 Like services or service suppliers

To determine when services or suppliers are 'like', the Appellate Body and Panels draw on their 'likeness' jurisprudence regarding GATT Article III. The criteria developed there play a significant role in the interpretation of 'likeness' in the context of the GATS; at the same time, it seems rather self-evident that that transfer will have to be applied with a pinch of salt, taking into account the particularities of trade in services.[198]

In *EC—Bananas III*, the Panel report came to the conclusion that foreign and domestic services and suppliers were like, without explaining this result in detail.

> [T]he *nature and the characteristics* of wholesale transactions as such, as well as of each of the different subordinated services mentioned in the headnote to section 6 of the CPC, are "like" when supplied in connection with wholesale services, irrespective of whether these services are supplied with respect to bananas of EC and traditional ACP origin, on the one hand, or with respect to bananas of third-country or non-traditional ACP origin, on the other. Indeed, it seems that each of the different service activities taken individually is virtually the same and can only be distinguished by

[194] *China—Publications and Audiovisual Products* (Appellate Body), paras. 396, 397 [footnotes omitted].

[195] *EC—Bananas III* (Appellate Body), para. 220.

[196] See also *China—Publications and Audiovisual Products* (Panel), para. 7.971 on the breadth of 'affecting': '[T]the term "affecting" is wider in scope than "regulating" or "governing"'.

[197] *Canada—Autos* (Appellate Body), para. 165.

[198] See, for example, Markus Krajewski and Maika Engelke, 'Art. XVII GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18 at 403–10

> referring to the origin of the bananas in respect of which the service activity is being performed . . .[199]

Apart from 'nature and characteristics', Panels have also considered consumer tastes and habits, albeit in an indirect fashion, for the determination of likeness[200] and service classifications pursuant to the Services Sectoral Classification List (W/120).[201] In more recent reports, Panels have focused on competitive relationships:

> Article XVII seeks to ensure equal competitive opportunities for like services of other Members. . . . [L]ike services are services that are in a competitive relationship with each other (or would be if they were allowed to be supplied in a particular market). Indeed, only if the foreign and domestic services in question are in such a relationship can a measure of a Member modify the conditions of competition in favour of one or other of these services.[202]

If a state measure is distinguishing on the basis of origin, Panels apply the procedural sanction developed in the context of the GATT:

> The measures at issue distinguish between suppliers that may be permitted to engage in the wholesale of imported reading materials and suppliers that are prohibited from engaging in this service, based exclusively on the suppliers' origin. When origin is the only factor on which a measure bases a difference of treatment between domestic service suppliers and foreign suppliers, the "like service suppliers" requirement is met, provided there will, or can, be domestic and foreign suppliers that under the measure are the same in all material respects except for origin.[203]

The Panel cautioned that 'in cases where a difference of treatment is not exclusively linked to the origin of service suppliers, but to other factors, a more detailed analysis would probably be required to determine whether service suppliers'[204] are 'like'.

With regard to the concept of likeness of the service supplier, the Panel in *EC—Bananas III* opined that, to the extent that services are like, those providing them are like service suppliers:

> Similarly, in our view, to the extent that entities provide these like services, they are like service suppliers.[205]

In fairness, the Panel probably did not want to establish likeness of the service as the only criterion determining likeness of suppliers; indeed, that restriction would be misplaced both on the basis of the wording of the provision and the negotiating history.[206]

[199] *EC—Bananas III* (Panel), para. 7.322 (emphasis added). [200] Ibid.

[201] Ibid., see also *Canada—Autos* (Panel), para. 10.289.

[202] *China—Electronic Payment Services* (Panel), para. 7.700.

[203] *China—Publications and Audiovisual Products* (Panel), para. 7.975 referring to two GATT disputes: *Canada—Wheat Exports and Grain Imports* (Panel), paras. 6.164–6.167 and *Argentina—Hides and Leather* (Panel), paras. 11.168–11.169.

[204] *China—Publications and Audiovisual Products* (Panel), para. 7.975.

[205] *EC—Bananas III* (Panel), para. 7.322; see also *Canada—Autos* (Panel), para. 10.307.

[206] See Werner Zdouc, 'WTO Dispute Settlement Practice Relating to the GATS' (1999) *Journal of International Economic Law* 2, 295, 332; cf. for further information Markus Krajewski and Maika Engelke,

Other issues, well developed in GATT law, have also been addressed in that context. For example, the question of whether only actual service suppliers may be entered into the equation or, rather, whether such entities that would have entered the market, provided the regulatory environment had not limited them, would also have to be addressed.[207] As GATS Article XVII is concerned with conditions of competition,[208] the latter is certainly a tenable proposition. However, the Appellate Body seems, on the facts of *Canada—Autos*, to hold a different view.[209] With regards to characteristics of service supplier, no case law yet exists. However, the Appellate Body has always emphasized that all likeness criteria are only indicative and supposed to establish a competitive relationship: this is clearly more an art than an exact science.

Like in the context of GATT, the aims and effects test has been rejected by the Appellate Body for the purposes of the GATS.

> The European Communities argues that the EC licensing system for bananas is not discriminatory under Articles II and XVII of the GATS, because the various aspects of the system, including the operator category rules, the activity function rules and the special hurricane license rules, "pursue entirely legitimate policies" and "are not inherently discriminatory in design or effect".
>
> We see no specific authority either in Article II or in Article XVII of the GATS for the proposition that the "aims and effects" of a measure are in any way relevant in determining whether that measure is inconsistent with those provisions. In the GATT context, the "aims and effects" theory had its origins in the principle of Article III:1 that internal taxes or charges or other regulations "should not be applied to imported or domestic products so as to afford protection to domestic production". There is no comparable provision in the GATS. Furthermore, in our Report in *Japan—Alcoholic Beverages*, the Appellate Body rejected the "aims and effects" theory with respect to Article III:2 of the GATT 1994 . . .[210]

We have elsewhere expressed the view that this comprehensive rejection may not be fully satisfactory.[211]

Whereas the issue of 'likeness' of services and service providers is far from being fully explored by the WTO jurisprudence, it is noteworthy that the criteria developed by Panels and the Appellate Body in interpreting GATT Article III have been used systematically in the context of the GATS.[212]

'Art. XVII GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18 at 407.

[207] *China—Publications and Audiovisual Products* (Panel), paras. 7.975 and 7.976.

[208] *EC—Bananas III* (Panel), para. 7.320.

[209] *Canada—Autos* (Appellate Body), para. 164 *et seq.*

[210] *EC—Bananas III* (Appellate Body), paras. 240, 241 (footnotes omitted).

[211] See Chapter 7 on national treatment.

[212] For further reading see, inter alia, Zdouc, 'WTO Dispute Settlement Practice Relating to the GATS', 295, 333; Lothar Ehring, 'De facto Discrimination in World Trade Law—National or Most-favoured Nation Treatment—or Equal Treatment?' (2002) *Journal of World Trade* 36, 921–77; Juan Marchetti and Petros Mavroidis, 'What are the Main Challenges for the GATS Framework? Don't Talk about Revolution' n. 112, 511–62.

5.3.2.4 Treatment no less favourable

Any measure that treats a service or a service provider of another member in a way that changes the competitive relationship to the detriment of the foreign product and its producer is treatment 'less favourable' and hence in violation of GATS Article XVII. This Article is concerned with the conditions of competition in favour of services or service suppliers of the member compared to like services or service suppliers of any other member (GATS Article XVII:3).[213] As always in the context of non-discrimination pursuant to WTO law, it is irrelevant whether the less favourable treatment is formally identical or formally different (GATS Article XVII:2).[214]

In *EC—Bananas III*, the Panel and the Appellate Body viewed a historically developed imbalance in allocated trading rights as 'treatment less favourable'. An EC licensing scheme distinguished between category A and B operators, depending on whether they had in a previous representative period marketed bananas originating in (preferentially treated) ACP (African, Caribbean, Pacific) or in dollar zone countries.[215] The rules applied to service suppliers regardless of their nationality, ownership, or control;[216] however, 'category A' operators were allocated 66.5 per cent of the licences required for the importation of dollar zone bananas, and 'category B' operators 30 per cent of the same licences.[217] In the Panel's view the allocation of the 30 per cent quota constituted less favourable treatment. The Appellate Body agreed:

> We concur, therefore, with the Panel's conclusion that "the allocation to Category B operators of 30 per cent of the licenses allowing for the importation of third-country and non-traditional ACP bananas at in-quota tariff rates creates less favourable conditions of competition for like service suppliers of Complainants' origin and is therefore inconsistent with the requirement of Article XVII of GATS". We also concur with the Panel's conclusion that the allocation to Category B operators of 30 per cent of the licenses for importing third-country and non-traditional ACP bananas at in-quota tariff rates is inconsistent with the requirements of Article II of the GATS.[218]

[213] cf. *China—Publications and Audiovisual Products* (Panel), para. 7.996: 'Since the measures at issue have the effect of prohibiting foreign service suppliers from wholesaling imported reading materials, while like [domestic] suppliers are permitted to do so, these measures clearly modifies the conditions of competition to the detriment of the foreign service supplier and thus constitutes "less favourable treatment" in terms of Article XVII.'

[214] cf. *China—Electronic Payment Services* (Panel), para. 7.687: 'Article XVII:3 . . . states that formally identical or different treatment is deemed less favourable "if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member". We deduce from this that, subject to all other Article XVII conditions being fulfilled, formally identical or different treatment of service suppliers of another Member constitutes a breach of Article XVII:1 if and only if such treatment modifies the conditions of competition to their detriment'.

[215] The ACP countries are, of course, signatories to the (then) Lomé and now Cotounou agreements (with the then European Community), which guarantee preferential access for many of their products to the EC market. The dollar zone countries are countries in Central and South America (such as Mexico, Ecuador, Honduras, etc.), which do not benefit from such preferential access to the EC market.

[216] *EC—Bananas III* (Panel), para. 7.324.

[217] Ibid. para. 7.350.

[218] *EC—Bananas III* (Appellate Body), para. 244.

5.3.3 Relationship with other provisions

5.3.3.1 Subsidies

One would not expect subsidies to come within the scope of GATS Article XVII, as the GATS does not contain a provision corresponding to GATT Article III:8. GATS Article XV, however, reads:

> Members recognize that, in certain circumstances, subsidies may have distortive effects on trade in services. Members shall enter into negotiations with a view to developing the necessary multilateral disciplines to avoid such trade-distortive effects [footnote omitted]. The negotiations shall also address the appropriateness of countervailing procedures. Such negotiations shall recognize the role of subsidies in relation to the development programmes of developing countries and take into account the needs of Members, particularly developing country Members, for flexibility in this area. For the purpose of such negotiations, Members shall exchange information concerning all subsidies related to trade in services that they provide to their domestic service suppliers.
>
> Any Member which considers that it is adversely affected by a subsidy of another Member may request consultations with that Member on such matters. Such requests shall be accorded sympathetic consideration.

Hence, one could expect that subsidies would be left completely unregulated under the GATS until future negotiations came to a fruitful end. The situation has, however, become confused, not least due to references in the 1993[219] and 2001 Scheduling Guidelines.[220] We quote from the latter:

> Article XVII applies to subsidies in the same way that it applies to all other measures. Article XV (Subsidies) merely obliges Members to "enter into negotiations with a view to developing the necessary multilateral disciplines" to counter the distortive effects caused by subsidies and does not contain a definition of subsidy. Therefore, any subsidy which is a discriminatory measure within the meaning of Article XVII would have to be either scheduled as a limitation on national treatment or brought into conformity with that Article. Subsidies are also not excluded from the scope of Article II (MFN). In line with the paragraph above, a binding under Article XVII with respect to the granting of a subsidy does not require a Member to offer such a subsidy to a services supplier located in the territory of another Member.

This interpretation is in line with the Appellate Body's restrictive interpretation of clauses obliging membership to negotiate on new disciplines: the Appellate Body refuses to interpret such provisions as implicitly insulating them from other disciplines in a given agreement.[221] As a consequence, a number of WTO members entered into horizontal commitments reserving payment of subsidies to their domestic suppliers. This is an area where clarification is urgently needed.

[219] GATT Doc. MTN.GNS/W/164, *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, Group of Negotiations on Services, 3 September 1993, para. 9.

[220] 2001 Scheduling Guidelines, n. 25, para. 16.

[221] cf. the relationship between the AoA and the SCM Agreement.

5.3.3.2 GATS Articles XVII and VI:5

Pending the entry into force of international disciplines mandated by Article VI:4, a WTO member must observe the disciplines provided for in GATS Article VI:5, provided it has undertaken specific commitments in a given sector. As the GATS does not explicitly determine the demarcation line between Article VI:5 and Article XVII, different opinions have been expressed on how to approach the possible overlap. Article VI covers measures such as qualification and licensing requirements, which could be subject to GATS Article XVII disciplines.

The Panel in *US—Gambling* was of the view that Articles XVII and VI:5 are mutually exclusive.[222] It seems that on the basis of that proposition scheduled exceptions to national treatment would not run afoul of future disciplines. If licensing and qualification requirements and technical standards are discriminatory, they should be scheduled under Article XVII.

5.4 Additional commitments

5.4.1 Overview

Pursuant to GATS Article XVIII,

> Members may negotiate commitments with respect to measures affecting trade in services not subject to scheduling under Articles XVI or XVII, including those regarding qualifications, standards or licensing matters. Such commitments shall be inscribed in a Member's Schedule.

Thus, GATS Article XVIII allows members to schedule commitments that go beyond Articles XVI and XVII. Whereas Articles XVI and XVII preview scheduling terms, limitations, conditions, and qualifications, the wording of Article XVIII does not mention any of these options.[223] In *US—Gambling*, the Panel attempted to analyse the interrelationship between GATS Articles XVI, XVII, and XVIII:

> [I]f a Member undertakes a full market access or a full national treatment commitment, it must not apply any measure that would be inconsistent with the provisions of those articles. Nonetheless, the drafters seem to have realized that there may be other types of restrictions that would not be covered by the disciplines of Articles XVI and XVII. In other words, there could be restrictions that would not be discriminatory and, therefore, would escape the provisions of Article XVII; nor would they be one of the six types of measures referred to in subparagraphs 2(a) to (f) of Article XVI. Apparently, it was considered that such measures would mainly, but not exclusively, relate to qualifications, standards and licensing matters. At the same time, it appears that it may not have been possible to arrive at a clear definition of the restrictive nature of such measures so that disciplines similar to those of Articles XVI and XVII could be established. It seems, therefore, that it was considered best to simply provide a legal framework for Members to negotiate and schedule specific

[222] *US—Gambling* (Panel), para. 6.305.
[223] See 2001 Scheduling Guidelines, n. 25, para. 19.

commitments that they would define, on a case-by-case basis, in relation to any measures that do not fall within the scope of Article XVI or XVII. That framework appears to have been provided in Article XVIII [footnote omitted].[224]

Consequently, WTO members are, in principle, free to negotiate any commitments additional to those they might have included in their schedules with regard to market access (Article XVI) and NT (Article XVII).

An example of what can be covered by GATS Article XVIII is offered by the so-called Reference Paper on Telecommunications.[225] Negotiators realized that in some markets they were dealing with major suppliers (incumbents) which exercised control over essential facilities and which were capable of frustrating market access. In order to target these anti-competitive practices, members decided to adopt six regulatory principles[226] aiming at guaranteeing market access. WTO members added in their schedules additional commitments on the basis of the Reference Paper, committing themselves to all the elements of the Reference Paper or at least some parts of it.

5.4.2 The mechanics of scheduling additional commitments

Pursuant to the 2001 Scheduling Guidelines,

> [a] Member may, in a given sector, make commitments with respect to measures affecting trade in services not subject to scheduling under Articles XVI and XVII. Such commitments can include, but are not limited to, undertakings with respect to qualifications, technical standards, licensing requirements or procedures, and other domestic regulations that are consistent with Article VI. Additional commitments are expressed in the form of undertakings, not limitations. In the schedule, the Additional Commitments column would only include entries where specific commitments are being undertaken, and need not include those modes of supply where there are no commitments undertaken or any entries at all where no Article XVIII undertakings are made.[227]

With *US—Gambling*, the importance of expressing precisely the extent of a commitment has become evident. The language introduced ought to be sufficiently specific to provide exact information on what has been agreed and what commitments have been made. At the end of the day, it will be up to the Appellate Body to interpret schedules in

[224] *US—Gambling* (Panel), para. 6.311.

[225] WTO, Negotiating Group on Basic Telecommunications, *Telecommunication Services: Reference Paper*, 24 April 1996, 36 *International Legal Materials* 367 (1997), also available at <https://www.wto.org/english/tratop_e/serv_e/telecom_e/tel23_e.htm>.

[226] For more information see Bernard Hoekman, Patrick Low, and Petros Mavroidis, 'Regulation, Competition Policy and Market Access Negotiations: Lessons from the Telecommunications Sector' in Einar Hope, ed., *Competition and Trade Policies* (Routledge, 1998) 115–39 and Petros Mavroidis and Damien Neven, 'The WTO Agreement on Telecommunications: It's Never Too Late' in Damien Geradin, ed., *The Liberalization of State Monopolies in the European Union and Beyond* (Kluwer, 2000) 307–18.

[227] 2001 Scheduling Guidelines, n. 25, para. 19.

line with general international law on treaty interpretation, as enshrined in VCLT Articles 31 and 32.

5.4.3 Relationship with other provisions

5.4.3.1 GATS Articles XVIII and II

To the extent that no specific exemption has been taken to this effect, additional commitments must be provided on a non-discriminatory basis.

5.4.3.2 GATS Articles XVIII and VI

Article XVIII appears to overlap with Article VI. However, it is important to make the distinction that Article XVIII allows WTO members to undertake commitments in several areas. Among others and by way of example, that Article includes qualifications, licensing, or standards. On the other hand, Article VI calls on members to develop a set of measures related exclusively to qualifications, licensing, and technical standards. Thus, it may be observed that Article XVIII is broader in scope than Article VI and allows members to undertake unilaterally commitments in areas not covered by Articles XVI and XVIII.[228]

5.4.3.3 GATS Articles XVIII and XIV

The chapeau of GATS Article XIV ('nothing in this Agreement shall be construed to prevent the adoption of enforcement by any Member of measures') makes it clear that GATS Article XIV can serve as a justification for violations of GATS Article XVIII as well.

5.4.3.4 GATS Articles XVIII and XXI

Whereas GATS Article XVIII concerns the entry of additional (but *original*) commitments, GATS Article XXI concerns the modification of *pre-existing* commitments.

6. General Exceptions

6.1 Introduction

GATS Article XIV, the parallel provision to GATT Article XX, provides an exhaustive list of general exceptions under the GATS.[229] It reads as follows:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services,

[228] See, for example, the analysis done by Panagiotis Delimatsis, 'Don't Gamble with the GATS—The Interaction between Arts. VI, XVI, XVII and XVIII in the Light of the Gambling Case' (2006) *Journal of World Trade* 40, 1059–80.

[229] Panagiotis Delimatis, 'Protecting Public Morals in a Digital Age: Revisiting the WTO Rulings on *US—Gambling* and *China—Publications and Audiovisual Products*' (2011) *Journal of International Economic Law* 14, 257–93.

nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:

(a) necessary to protect public morals or to maintain public order;
(b) necessary to protect human, animal or plant life or health;
(c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:
  (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;
  (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;
  (iii) safety;
(d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members;
(e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound [footnotes omitted].

Both the structure and several terms used in GATS Article XIV mirror the corresponding GATT provision (Article XX). As a consequence, the Appellate Body allows the jurisprudence under GATT Article XX to inform the interpretation of GATS Article XIV.[230] For instance, the two-tier test developed for GATT Article XX has been transferred into the world of GATS: For a measure to be justified under GATS Article XIV, it must be provisionally justified under a particular subparagraph and then meet the requirements of the chapeau:

> Article XIV of the GATS, like Article XX of the GATT 1994, contemplates a "two-tier analysis" of a measure that a Member seeks to justify under that provision. A Panel should first determine whether the challenged measure falls within the scope of one of the paragraphs of Article XIV. This requires that the challenged measure address the particular interest specified in that paragraph and that there be a sufficient nexus between the measure and the interest protected. The required nexus—or "degree of connection"—between the measure and the interest is specified in the language of the paragraphs themselves, through the use of terms such as "relating to" and "necessary to". Where the challenged measure has been found to fall within one of the paragraphs of Article XIV, a Panel should then consider whether that measure satisfies the requirements of the chapeau of Article XIV [footnotes omitted].[231]

Note, however, that despite the textual similarities and the cited jurisprudence, differences exist: Article XIV provides only five grounds justifying deviations from obligations assumed under the GATS, whereas GATT Article XX offers more possible justifications. With regard to the first three public interests ('(a) necessary to protect

[230] *US—Gambling* (Appellate Body), para. 291.
[231] Ibid. para. 292, confirming *US—Gambling* (Panel), para. 6.449.

public morals or to maintain public order; (b) necessary to protect human, animal or plant life or health; (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement'), only measures that are both 'necessary' to achieve the end sought and which meet the requirements of the chapeau (that is, they are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services) will be justified by GATS Article XIV. On the other hand, some of the interests mentioned in GATS Article XIV, such as the maintenance of 'public order', the protection of individual privacy, confidentiality of individual records and safety, and the 'equitable or effective imposition or collection of direct taxes' are not mentioned in the GATT.

Whereas subparagraphs (a) to (c) allow for deviations from *any* GATS provision, provided the deviation is necessary, the subparagraphs (d) and (e) allow for deviations only from specifically mentioned GATS provisions, namely the two non-discrimination provisions of Article II (MFN, a general obligation) and Article XVII (NT, an obligation dependent on a specific commitment). Also, necessity is not required in those two instances.

6.2 Necessity in GATS Article XIV

The concept of 'necessity', required for the first three protected interests, was explored by the Appellate Body in *US—Gambling*.[232] There, Antigua and Barbuda complained about US legislation (both federal and state) banning remote supply of gambling services. According to the complaint, this legislation amounted to a total prohibition of remote gambling, whereas the United States had (possibly erroneously, but nevertheless in a binding fashion) committed to grant market access. Also, certain internal offerings seemed to have received a significantly better treatment than the foreign service providers.

Both the Panel and the Appellate Body held that the United States should have indicated in its schedule of concessions that it was banning remote gambling and that, in absence of such indication, it was in violation of its market access obligations pursuant to GATS Article XVI. The United States attempted to justify its measures under both GATS Article XIV(a) and XIV(c). Overturning the Panel's findings in this respect, the Appellate Body made two important contributions to the interpretation of the necessity requirement under GATS Article XIV.

First, it clarified the standard of review to be applied by a WTO adjudicating body when confronting this issue:

> The process begins with an assessment of the "relative importance" of the interests or values furthered by the challenged measure. Having ascertained the importance of the particular interests at stake, a Panel should then turn to the other factors that are to be "weighed and balanced". The Appellate Body has pointed to two factors that, in most cases, will be relevant to a Panel's determination of the "necessity" of a measure,

[232] See, Joost Pauwelyn, '"*Rien ne va plus?*" Distinguishing Domestic Regulation from Market Access in GATT and GATS' (2005) *World Trade Review* 4(2), 131–70.

although not necessarily exhaustive of factors that might be considered. One factor is the contribution of the measure to the realization of the ends pursued by it; the other factor is the restrictive impact of the measure on international commerce.

A comparison between the challenged measure and possible alternatives should then be undertaken, and the results of such comparison should be considered in the light of the importance of the interests at issue. It is on the basis of this "weighing and balancing" and comparison of measures, taking into account the interests or values at stake, that a Panel determines whether a measure is "necessary" or, alternatively, whether another, WTO-consistent measure is "reasonably available".

The requirement, under Article XIV(a), that a measure be "necessary"—that is, that there be no "reasonably available", WTO-consistent alternative—reflects the shared understanding of Members that substantive GATS obligations should not be deviated from lightly. An alternative measure may be found not to be "reasonably available", however, where it is merely theoretical in nature, for instance, where the responding Member is not capable of taking it, or where the measure imposes an undue burden on that Member, such as prohibitive costs or substantial technical difficulties. Moreover, a "reasonably available" alternative measure must be a measure that would preserve for the responding Member its right to achieve its desired level of protection with respect to the objective pursued under paragraph (a) of Article XIV.[233]

Obviously, the Appellate Body draws on its jurisprudence regarding GATT Article XX,[234] according to which the determination of necessity will be a process of weighing and balancing in which (1) the relative importance of the interest protected by the state measure,[235] (2) the contribution by that measure to the attainment of the goal pursued,[236] and (3) the restrictive impact on the WTO legal regime ('on international trade')[237] are the determinant considerations.

Second, the Appellate Body clarified the allocation of the burden of proof when a GATS Article XIV defence is raised. Overturning the Panel's findings in this respect, the Appellate Body held that the original burden of proof rests with the WTO member raising the defence. Only if it has made a prima facie case does the burden of proof shift back to the complaining party who will have to demonstrate that the use of another, less restrictive (but similarly effective) measure would have been possible. If the party succeeds in doing that, the burden of proof will shift back again to the party raising the GATS Article XIV defence. This time, however, it will have to demonstrate that this measure was not reasonably available to it:

[A] responding party invoking an affirmative defence bears the burden of demonstrating that its measure, found to be WTO-inconsistent, satisfies the requirements of the invoked defence. In the context of Article XIV(a), this means that the responding party must show that its measure is "necessary" to achieve objectives relating to public

[233] *US—Gambling* (Appellate Body), paras. 306–8 (footnotes omitted).
[234] See, for example, *Korea—Various Measures on Beef* (Appellate Body), paras. 180–1.
[235] *US—Gambling* (Appellate Body), para. 307.
[236] See, for example, *EC—Asbestos* (Appellate Body), para. 168; *Korea—Various Measures on Beef* (Appellate Body), para. 163; *Mexico—Taxes on Soft Drinks* (Appellate Body), para. 74.
[237] See, for example, *Korea—Various Measures on Beef* (Appellate Body), para. 163.

> morals or public order . . . [and] to make a *prima facie* case that its measure is "necessary" by putting forward evidence and arguments that enable a panel to assess the challenged measure in the light of the relevant factors to be "weighed and balanced" in a given case. The responding party may, in so doing, point out why alternative measures would not achieve the same objectives as the challenged measure, but it is under no obligation to do so in order to establish, in the first instance, that its measure is "necessary". . . .
>
> If, however, the complaining party raises a WTO-consistent alternative measure that, in its view, the responding party should have taken, the responding party will be required to demonstrate why its challenged measure nevertheless remains "necessary" in the light of that alternative or, in other words, why the proposed alternative is not, in fact, "reasonably available". If a responding party demonstrates that the alternative is not "reasonably available", in the light of the interests or values being pursued and the party's desired level of protection, it follows that the challenged measure must be "necessary" within the terms of Article XIV(a) of the GATS.[238]

6.3 Public interests protected by GATS Article XIV

Article XIV protects several specific interests: public morals and public order; human, animal or plant life, or health; and the interest of members to secure compliance with their legal order. In addition, GATS Article XIV(d) and (e) address very specific possibilities to depart from national treatment or MFN in the context of tax law.

6.3.1 Public morals and public order

The *US—Gambling* case was the first time the public order exception had to be addressed by dispute settlement bodies.[239] Wisely, GATS Article XIV has been drafted differently from GATT Article XX and adds to the similarly used term 'public morals' the wider term 'public order'.[240] In its report, the Appellate Body expressed the view that the definition of the term 'order' read in conjunction with footnote 5 suggest that 'public order' refers to the preservation of the fundamental interests of a society:

> In its analysis under Article XIV(a), the Panel found that "the term 'public morals' denotes standards of right and wrong conduct maintained by or on behalf of a community or nation." The Panel further found that the definition of the term "order", read in conjunction with footnote 5 of the GATS, "suggests that 'public order' refers to the preservation of the fundamental interests of a society, as reflected in public policy and law." The Panel then referred to Congressional reports and

[238] *US—Gambling* (Appellate Body), paras. 309–11 (footnotes omitted).

[239] The most recent case in this area is *China—Audiovisual Products*, paras. 7.725–7.914. There, the moral exception was raised in the context of GATT Art. XX.

[240] See Thomas Cottier, Panagiotis Delimatsis, and Nicolas Diebold, 'Art. XIV GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18, 299, para. 24: '"[P]ublic Order" can be regarded as a catch-all term.' 'It . . . includes public morals.' However, the authors point out (ibid. para. 25) that the requirements of fn. 5 only apply to public order thus privileging public morals, which are not required to meet that standard.

> testimony establishing that "the government of the United States consider[s] [that the Wire Act, the Travel Act, and the IGBA] were adopted to address concerns such as those pertaining to money laundering, organized crime, fraud, underage gambling and pathological gambling." On this basis, the Panel found that the three federal statutes are "measures that are designed to 'protect public morals' and/or 'to maintain public order' within the meaning of Article XIV(a)."[241]

The Appellate Body clearly subscribed to a reading that gives members considerable leeway to allow interest they deem fundamental to prevail over trade liberalization obligations:

> Members, in applying similar societal concepts, have the right to determine the level of protection that they consider appropriate. . . . Members should be given some scope to define and apply for themselves the concepts of "public morals" and "public order" in their respective territories, according to their own systems and scales of values.[242]

This approach seems particularly appropriate in the context of services, where such interests are much more easily affected than in the context of goods. In any case, students of WTO law will note that the reading of the public interests is wide and the tendency of WTO adjudicating bodies is to understand it as such.[243]

6.3.2 *Human, animal or plant life, or health*

The notion that the protection of human, animal or plant life, or health should allow deviation from general obligations has been transferred lock, stock, and barrel from the GATT. Therefore, GATS jurisprudence may draw heavily from pertinent GATT jurisprudence.[244] However, despite the identical wording the interpretation of the norm in the GATS will have to be broader. Other than GATT Article XX(g), GATS Article XIV does not explicitly address protective measures 'relating to the conservation of natural resources'.

6.3.3 *Measures to secure compliance with GATS-compatible laws and regulations*

According to GATS Article XIV(c) measures 'necessary to secure compliance with laws or regulations which are not inconsistent' with the GATS are justifiable. In *US—Gambling*, the Panel presented the following test:

[241] *US—Gambling* (Appellate Body), para. 296 (footnotes omitted); the Appellate Body upheld the Panel's conclusion (*US—Gambling* (Panel), para. 6.487) that legislation put in place to address organized crime, money laundering, fraud, and other criminal activities; risks to children given the availability of remotely supplied gambling and betting services to children, could fall under GATS Art. XIV(a), para. 299.

[242] *US—Gambling* (Panel), para. 6.461, referring to *Korea—Various Measures on Beef* (Appellate Body), para. 176 and *EC—Asbestos* (Appellate Body), para. 168. Note that the Panel, while recognizing that public order and public morals are not identical concepts, underlined their similar purpose. Therefore, those concepts may overlap, ibid. para. 6.468.

[243] For further analysis and references see Thomas Cottier, Panagiotis Delimatsis, and Nicolas Diebold, 'Art. XIV GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18, 298 *et seq*., paras. 19–29.

[244] See, for example, *EC—Asbestos* with regard to health; *US—Shrimp* with regard to environmental and natural resources.

> [T]hree elements must be demonstrated by the Member who invokes Article XIV(c), namely:
> (a) the measure for which justification is claimed must "secure compliance" with other laws or regulations;
> (b) those other "laws or regulations" must not be inconsistent with the WTO Agreement; and
> (c) the measure for which justification is claimed must be "necessary" to secure compliance with those other laws or regulations.[245]

The examples of legitimate interests listed in Article XIV(c)(i) to (iii)[246] do not constitute a closed list, as the term 'including' at the beginning of the list makes clear.[247] In *US—Gambling*, the Panel laid out its understanding of the type of measures that could legitimately come under GATS Article XIV(c) in the following manner:

> [T]he reference to "secure compliance" in Article XIV means that the measures for which justification is sought must "enforce" the relevant laws and regulations. Second, it indicates that the measures for which justification is sought must enforce "obligations" contained in the laws and regulations rather than merely ensure attainment of the objectives of those laws and regulations.[248]

With regard to the degree to which a measure must 'secure compliance' with obligations under other laws and regulations, the same Panel recalled the Panel's decision in *Korea—Various Measures on Beef* that recognized that a measure need not be designed *exclusively* to 'secure compliance' with the justifying law. Rather, the Panel in that case accepted that it was sufficient if a measure was put in place, at least *in part*, in order to secure compliance with the justifying legislation.[249]

These considerations, despite being developed in the context of GATT Article XX, also seem relevant here.

6.3.4 Discriminating measures relating to taxation and double taxation agreements

GATS Article XIV(d) allows derogations from the national treatment obligation for the purposes of equitable and effective imposition and collection of direct taxes,[250] whereas subparagraph (e) allows deviations from the general MFN obligation as a consequence of double taxation agreements.[251]

[245] *US—Gambling* (Panel), para. 6.536, referring to *Korea—Various Measures on Beef* (Appellate Body) para. 157.

[246] '(i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts; (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts; (iii) safety'.

[247] *US—Gambling* (Panel), para. 6.540.

[248] Ibid. para. 6.538.

[249] Ibid. para. 6.539 referring to *Korea—Various Measures on Beef*, para. 658.

[250] A definition of direct taxes is provided by GATS Art. XXVIII (o).

[251] cf. fn. 59 of the SCM Agreement.

The difficult task of interpreting the terms 'equitable' and 'effective' in subparagraph (d) is made considerably easier by the existence of footnote 6, which provides the addressees of the GATS with an exhaustive list of six types of measures:

> Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:
> (i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or
> (ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
> (iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
> (iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
> (v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
> (vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.
>
> Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.

6.4 Compliance with the chapeau of GATS Article XIV

As the chapeau of GATS Article XIV is almost verbatim identical to its sister paragraph in GATT Article XX, the relevant rich jurisprudence of the Appellate Body can and should be used for the interpretation.[252] The requirements of the chapeau come into play, if and after it has been established that requirements from subparagraphs (a) to (e) have been met. Such 'provisionally' justified measures will not benefit from the exception of GATS Article XIV, if they 'constitute a means of arbitrary or unjustifiable discrimination' or 'a disguised restriction on trade in services'.

According to *US—Gambling*, the chapeau requires WTO members to behave in a consistent manner across (comparable) situations.[253] In the case at hand, the Panel and the Appellate Body faced an argument by Antigua and Barbuda to the effect that the United States was acting in a discriminatory manner when it was prohibiting remote gambling for both domestic and foreign suppliers, whereas the Interstate Horseracing

[252] For further references cf. Thomas Cottier, Panagiotis Delimatsis, and Nicolas Diebold, 'Art. XIV GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, n. 18, 321–6, paras. 70–9.

[253] *US—Gambling* (Panel), para. 6.581: '[T]he chapeau of Article XX of the GATT 1994 addresses not so much a challenged measure or its specific content, but rather the manner in which that measure is applied, with a view to ensuring that the exceptions of Article XX are not abused. In order to do so, the chapeau of Article XX identifies three standards which may be invoked in relation to the same facts: arbitrary discrimination, unjustifiable discrimination and disguised restriction on trade. In our view, these principles would also be applicable in relation to Article XIV of the GATS.'

Act (IHA) was allowing US suppliers (but not foreign suppliers!) to supply certain remote gambling services. The Appellate Body upheld a Panel finding to the effect that such treatment was indeed discriminatory and in violation of the requirements under the chapeau of GATS Article XIV.[254] In order to establish discriminatory treatment, complainants must show evidence of patterns of discriminatory enforcement and not mere individual instances of differential treatment.[255] This requires fairly comprehensive research and preparation for any dispute settlement initiative.

7. Overview: Specific Rules for Telecommunications and Financial Services

The GATS entered into force as an integral part of the Marrakesh Agreement. However, three GATS sector-specific negotiations had not been completed by that time, namely telecommunications, financial services, and maritime transport. As of now, Annexes establish specific rules for the following service sectors: air transport services, financial services, maritime transport services, and (basic) telecommunications.[256] We briefly introduce the special regimes for telecommunications and financial services.

7.1 Telecommunications

7.1.1 Sources of law

The rules applicable to telecommunications services are to be found in: (a) the GATS, (b) the Annex on Telecommunications, (c) the regulatory principles reflected in the Reference Paper,[257] and (d) the schedules of specific commitments.[258]

Pursuant to GATS Article XXIX, the Annexes are an integral part of the GATS, much like the schedules of specific commitments pursuant to GATS Article XX:3. The legal nature of the Reference Paper is more complex. It is a set of regulatory principles that are legally binding for those WTO governments which have committed to them by appending the document, in whole or in part, to their schedules of commitments.

7.1.1.1 The Annex

The Annex was supposed to provide 'notes and supplementary provisions to the Agreement'. Members wanted to ensure that all service suppliers seeking to take advantage of scheduled commitments would be accorded access to and use of public basic telecommunications, both networks and services, on a reasonable and non-discriminatory basis. It is important to note that all members incur these

[254] *US—Gambling* (Appellate Body), paras. 369, 372, and 373 (D)(v). [255] Ibid. para. 356.

[256] cf. Annex on Air Transport Services, Annex on Financial Services, Second Annex on Financial Services, Annex on Negotiations on Maritime Transport Services, Annex on Telecommunications, Annex on Negotiations on Basic Telecommunications.

[257] WTO, Negotiating Group on Basic Telecommunications, *Telecommunication Services: Reference Paper*, 24 April 1996, 36 *International Legal Materials* 367 (1997), also available at <https://www.wto.org/english/tratop_e/serv_e/telecom_e/tel23_e.htm>.

[258] All schedules, besides specific commitments, reflect the Reference Paper, albeit, as already stated, not necessarily in identical terms. One hundred and eight WTO members so far have undertaken specific commitments in the field of telecommunications.

obligations, irrespective of whether or not they have entered specific commitments in telecoms.

More specifically, the Annex imposes both an obligation to ensure transparency with respect to any relevant information affecting access to and use of public telecommunications transport networks and services (paragraph 4) and an obligation to guarantee access to and use of public telecoms transport networks and services.[259] Paragraph 5, in relevant part, reads:

> Each Member shall ensure that any service supplier of any other Member is accorded access to and use of public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions, for the supply of a service included in its Schedule.

The following paragraphs state that suppliers of such services are entitled to access to and use of any public telecoms transport network or service offered within or across the border, including private leased circuits, the right to purchase or lease and attach terminal or other equipment to the network, and to interconnect private leased or owned circuits with public telecoms transport network and services, or with circuits leased or owned by another service supplier.

7.1.1.2 The Reference Paper

7.1.1.2.1 The rationale for negotiating the Reference Paper

Some negotiators felt that commitments under the Annex were too general to guarantee new entrants adequate opportunity to compete.[260] For instance, the term 'reasonable terms' appearing in paragraph 5 of the Annex is not a self-interpreting term, and it was felt that more substantial normative guidance should be provided.[261]

The need for extra detail was not, however, the only rationale for negotiating the Reference Paper:[262] some WTO members had already privatized their telecoms market. It was felt that, absent specific language that would oblige WTO members to impose their WTO obligations on their private carriers, the whole edifice would be likely to run into serious trouble: private entities could impede access to foreign carriers in various ways. The Reference Paper was thus also conceived as a means to bridge the gap between international obligations and their observance by private entities. By providing for six regulatory principles, it aims to provide a framework capable of addressing most of the questions arising in the context of the telecoms liberalization.

[259] Annex, para. 5.

[260] WTO, Negotiating Group on Basic Telecommunications, *Telecommunication Services: Reference Paper*, n. 257.

[261] Proposals were made to define interconnection rights more specifically (including proposals on cost-based pricing, and on unbundling, that is, to allow new entrants a choice as to which services to buy from the network operator, rather than to oblige them to purchase a package that may raise costs and undermine competitiveness).

[262] See, on this issue, Bernard Hoekman, Patrick Low, and Petros Mavroidis, 'Regulation, Competition Policy and Market Access Negotiations: Lessons from the Telecommunications Sector' in Einar Hope, ed., *Competition and Trade Policies* (Routledge, 1998) 115–39.

7.1.1.2.2 The Reference Paper summarized

The Reference Paper incorporates six regulatory principles:

(a) competitive safeguards to prevent anti-competitive practices in telecoms;
(b) interconnection;
(c) the right to require universal service;
(d) public availability of licensing criteria;
(e) establishment of independent regulatory bodies; and
(f) the use of objective, transparent, and non-discriminatory allocation procedures for scarce resources such as frequency, numbers, and the right of way.

(a) Anti-competitive practices envisaged. The Reference Paper does not enumerate the anti-competitive (restrictive business) practices (RBPs) that must be prevented. However, it does provide an indicative list:

(a) engaging in anti-competitive cross-subsidization;
(b) using information obtained from competitors with anti-competitive results; and
(c) not making available to other service suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

The Panel, in its report on *Mexico—Telecoms*[263] faced an argument from the United States that Mexico was acting inconsistently with Section 1.1 of its Reference Paper by not acting against anti-competitive practices as it ought to in accordance with its national law. The United States complained because, in their view, Mexico was tolerating RBPs (in which Telmex, the dominant carrier was the leader), which resulted in unreasonable interconnection rates.[264] Section 1.1 of the Mexico Reference Paper reads:

> Appropriate measures shall be maintained for the purpose of preventing suppliers who alone or together, are a major supplier from engaging in or continuing anti-competitive practices.

Note that Section 1.1 of the Mexico Reference Paper is a faithful reproduction of Section 1.1 of the Reference Paper. In the US view, this section, in the absence of a precise definition of RBPs, obliged Mexico to address practices usually proscribed by national law such as, abuse of dominance, monopolization, and cartelization. In this particular case, in the US view, Section 1.1 obliged Mexico to proscribe a horizontal price-fixing cartel led by Telmex, the Mexican national supplier of telecoms services.[265] The Panel agreed. In paragraph 7.234 it interprets the provision in Section 1.1 as extending to cover horizontal price-fixing cartels. The Panel found support for its view

[263] *Mexico—Telecoms* (Panel).
[264] On the facts of the case, see Paul Mardsen, 'Trade and Competition. WTO Decides First Competition Case—With Disappointing Results' (2004) *Competition Law Insight*, 3–9.
[265] *Mexico—Telecoms* (Panel), para. 7.222.

in the object and purpose of the Reference Paper,[266] in the substantive content of national competition laws,[267] and in international instruments ranging from the Havana Charter, to OECD Recommendations[268] to the WTO Working Group on the interaction between trade and competition policy.[269]

(b) Interconnection. Paragraph 2.2 of the Reference Paper refers to 'interconnection with a major supplier', which is defined as follows:

> A major supplier is a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of:
> (a) control over essential facilities; or
> (b) use of its position in the market.[270]

There is no indication, however, as to how the term 'relevant market' should be defined. In *Mexico—Telecoms*, the Panel used demand substitutability as the relevant criterion:

> Is this market for termination the "relevant" market? For the purposes of this case, we accept the evidence put forward by the United States, and uncontested by Mexico, that the notion of demand substitution—simply put, whether a consumer would consider two products as "substitutable"—is central to the process of market definition as it is used by competition authorities. Applying that principle, we find no evidence that a domestic telecommunications service is substitutable for an international one, and that an outgoing call is considered substitutable for an incoming one. One is not a practical alternative to the other. Even if the price difference between domestic and international interconnection would change, such a price change would not make these different services substitutable in the eyes of a consumer. We accept, therefore, that the "relevant market for telecommunications services" for the services at issue—voice, switched data and fax—is the termination of these services in Mexico.[271]

Based on this market definition, the Panel found that Telmex was indeed a major supplier, since it was legally required to negotiate settlement rates for the whole relevant market, that is, the market for termination rates.[272]

(c) International interconnection. At the heart of the dispute between the United States and Mexico in the litigation that led to the Panel report on *Mexico—Telecoms* was the question of whether the obligation to grant interconnection covered only mode 3 (commercial presence) or mode 1 (cross-border) as well. The Panel accepted that it was indeed facing a cross-border supply of service:

[266] Ibid. para. 7.237.
[267] Ibid. para. 7.235.
[268] OECD Council Recommendation Concerning Effective Action Against Hardcore Cartels (adopted by the OECD Council at its 921st Session on 25 March 1998 [C/M(98)7/PROV]).
[269] Ibid. para. 7.236; cf. Damien Neven and Petros Mavroidis, 'El mess in TELMEX' in Henrik Horn and Petros Mavroidis, eds., *The American Law Institute Reporters' Studies on WTO Case Law* (Cambridge University Press, 2007).
[270] Definitions section.
[271] *Mexico—Telecoms* (Panel), para. 7.152.
[272] Ibid. paras. 7.159, 7.227.

> More generally, a supplier of services under the GATS is no less a supplier solely because elements of the service are subcontracted to another firm, or are carried out with assets owned by another firm. What counts is the service that the supplier offers and has agreed to supply to a customer. In the case of a basic telecommunications service, whether domestic or international, or supplied cross-border or through commercial presence, the supplier offers its customers the service of completing the customer's communications. Having done so, the supplier is responsible for making any necessary subsidiary arrangements to ensure that the communications are in fact completed. The customer typically pays its supplier the price of the end-to-end service, regardless of whether the supplier contracts with, or uses the assets of, another firm to supply the services.[273]

The Panel went on to uphold the US point of view, finding that interconnection covers not only mode 3 but mode 1 as well.[274] We quote:

> In sum the ordinary meaning, in the heading of Section 2 of Mexico's Reference Paper, of the term "interconnection"—that it does not distinguish between domestic and international interconnection, including through accounting rate regimes—is confirmed by an examination of any "special meaning" that the term "interconnection" may have in telecommunications legislation, or by taking into account potential commercial, contractual or technical differences inherent in international interconnection. We find that any "special meaning" of the term "interconnection" in Section 2 of Mexico's Reference Paper does not justify a restricted interpretation of interconnection, or of the term "linking", which would exclude international interconnection, including accounting rate regimes, from the scope of Section 2 of the Reference Paper.[275]

This is not, however, the manner in which the Panel described the transaction it was reviewing. It ended up with an untenable outcome.

(d) Cost-oriented rates for interconnection. The term 'cost-oriented', which appears in the Reference Paper is far from being self-interpreting. The Panel in its report on *Mexico—Telecoms* addressed the argument by the United States that the interconnection rates offered by Telmex were not cost-oriented. The Panel noted that rates 'that are "cost-oriented" would not need to equate exactly to cost, but should be founded on cost.'[276] The Panel accepted that the principle of causality between the service supplied

[273] Ibid. para. 7.42. This passage comes under the heading '*(b) Are the services at issue supplied cross-border?*' appearing at 144 of the Panel report.

[274] Ibid. paras. 7.108–7.117.

[275] Ibid. para. 7.117; Damien Neven and Petros Mavroidis, 'El mess in TELMEX' in Henrik Horn and Petros Mavroidis, eds., *The American Law Institute Reporters' Studies on WTO Case Law* (Cambridge University Press, 2007), have criticized this part of the report: 'As indicated above, an international call from the US to Mexico can be seen as the bundle of two strict complements, namely a routing from the US subscriber to the border and a termination within Mexico. The US operator is selling the bundle to a US subscriber and is purchasing one element of the bundle (one input) from a Mexican operator. From this perspective, Mexican operators are thus selling one service (termination) to a foreign firm. In other words, they are producing a service using domestic inputs and selling it to a foreign undertaking. This is literally a mode I type of supply but in this perspective the supplier is the Mexican operator which terminates the call (and not the US operator, as considered by the Panel).'

[276] *Mexico—Telecoms* (Panel), para. 7.168.

and the resources used to provide was the key for the proper interpretation of this term. The principle of causality is reflected in Recommendation D.140 of the International Telecommunications Union (ITU). Since most WTO members are members of the ITU as well, the Panel moved to embrace this principle and use it in order to define what cost-oriented rates amount to.[277]

7.1.2 Scheduling commitments regarding telecommunications

7.1.2.1 The telecoms specificity of the Services Sectoral Classification List

The Services Sectoral Classification List distinguishes between fourteen sub-sectors of telecommunications: sub-sectors (a) to (g) and some other services, including mobile communications, providing real-time transmission of customer supplied information (normally listed under sub-sector (o)), are basic telecommunication services; sub-sectors (h) to (n) and any other services, not supplied on a real-time basis or which transform the form or content of customer's information, are value-added telecommunication services. The distinction between basic and value-added telecommunication services appears in a series of WTO documents on telecoms although it does not necessarily correspond to national classification schemes. Increasingly, in liberalized markets any distinction between basic and value-added services may have little importance, except possibly in relation to defining public or universal service objectives. In partially liberalized markets, however, the distinction may continue to have some bearing on defining the scope of services which are to remain under exclusivity and of those which will not.

WTO Secretariat Note S/C/W/74[278] mentions additional factors supporting the view that the existing classification will have to be re-visited sooner rather than later:

> [T]he enhanced ability to integrate different technologies, and the advent of service suppliers who distinguish themselves not by specializing in particular telecom services, but rather by the market segments they seek to serve. Voice, data, fax, and a full range of value-added telecom services can and are being carried indiscriminately as digitalized information flows over telephony networks or leased lines of just about any supplier. Even distinctions between fixed and mobile telephony are crumbling as some suppliers can now offer both as an integrated package, can arrange to re-route calls to a customer's fixed telephone to its mobile telephone upon demand, and will soon be able to offer a wireless handset that converts itself from fixed service to mobile service if carried out of range of the fixed handset base. Market forces are giving rise to telecom service suppliers that may more accurately break down into categories characterized as wholesale versus retail, infrastructure owners versus resellers, or international versus national service providers than into categories based on supply of voice versus data, for example.[279]

[277] Ibid. paras. 7.171–7.174.
[278] WTO Doc. S/C/W/74, Council for Trade in Services, *Telecommunication Services*, Background Note by the Secretariat, 8 December 1998.
[279] Ibid. para. 9.

7.1.2.2 Level of commitments by modes of supply

The WTO Secretariat Note S/C/W/74 sums up in the following terms the discussion on this issue:

> In terms of the extent of market access commitments under the different modes of supply, there were fairly marked differences when basic services (sub-sectors a. through g.) are compared with value-added services (sub-sectors h. through n.). Generally, table A1 shows that fewer limitations were listed with respect to value-added services for all modes of supply. For cross-border supply of various value-added services, between 31 and 37 per cent of governments committing listed no limitations, whereas for the basic services only 12 to 20 per cent committed fully with no limitations. With respect to consumption abroad, value-added services were listed with no limitations by between 44 and 51 per cent of committing governments, while the corresponding figure for basic services ranged between 31 and 49 per cent. Likewise, commercial presence for value-added services was fully liberalized without limitation in 17 to 21 per cent of commitments, but only in 9 to 11 per cent of commitments on basic telecommunications. However, fewer governments refrained from commitments (i.e. by entering "unbound") with respect to commercial presence than for any other of the modes of supply; this was true for both basic and value added services.
>
> The pattern of commitments by industrialized economies with respect to market-access for the modes of supply differed somewhat from the overall picture presented above. Industrialized economies were two to three times more likely than the norm to commit to unlimited market access for cross border supply for basic telecom services; between 36 to 43 per cent of them did so. Moreover, they were about twice as likely to make unrestricted commitments on the supply of basic telecom services via the other two modes of supply, at between 64 to 70 per cent for consumption abroad and 14 per cent for commercial presence. Finally, all industrialized countries committed either fully or partially on all basic services, there being no cases of "unbound" entries listed for any of the services or modes of supply. This means that all incidences of "unbound" entries on basic services with respect to particular modes of supply are accounted for by emerging economies, and this was more often done in respect to cross-border and consumption abroad, than in respect to commercial presence.
>
> The above analysis indicates that priorities in respect to modes appear to differ between industrialized and emerging economies. For industrialized economies, cross border and consumption abroad are much more open than commercial presence. Whereas emerging economies, although they also record fewer limitations on cross border supply and consumption abroad, have recorded a higher incidence of commitments, overall, on commercial presence, when both full and partial commitments are taken into account. New technologies involving satellites and simple resale techniques will make it possible for supply of telecom services through cross-border supply and consumption abroad to assume much more importance than in the past. However, the economic benefits of this trend can only be realized in the most liberalized markets. Commercial presence in one form or another will nevertheless remain important to many service suppliers, and it appears will still remain an

important prerequisite for service suppliers who wish to participate in emerging markets. Their commitments illustrate the importance they have attached to foreign direct investment as a means of improving and extending national telecom networks and universal access.[280]

7.1.2.3 Types of limitations maintained

For this issue as well, we turn to the WTO Secretariat Note S/C/W/74 at paragraph 24:

> Overall, three types of market access limitations are most commonly listed in telecom commitments. These are: limitations on the number of suppliers, restrictions on type of legal entity and, a related measure, limits on the participation of foreign capital. A variety of "other" limitations, or measures not fitting neatly into the six categories of market access restrictions defined in GATS Article XVI, are also listed. As implied above, the limitations are, by far, most often associated with commitments on commercial presence for basic services.

7.2 Financial services

The multilateral rules and disciplines with respect to trade in financial services can be found in the GATS, in the GATS Annex on Financial Services, and in the Understanding on Commitments in Financial Services. As for other types of services, the rules and disciplines applicable to financial services are primarily laid down in the GATS. The Annex on Financial Services, as well as the Understanding on Commitments in Financial Services, contain specific provisions with respect to trade in financial services that complement or/and modify certain provisions of the GATS.[281]

7.2.1 The Annex on Financial Services

The Annex on Financial Services is an integral part of the GATS that applies to 'measures affecting the supply of financial services'. It contains provisions on the scope of the GATS with respect to financial services, domestic regulation, recognition, dispute settlement, and definitions. The Annex does not include any specific commitments with respect to trade in financial services, but rather concerns the application of the GATS to the financial services sector. For that reason it provides the definitions of the following: 'financial services', 'services supplied in the exercise of governmental authority', 'financial service supplier', and 'public and a private entity'.

[280] Ibid. paras. 21–23.

[281] cf. James Barth, Juan Marchetti, Daniel Nolle, and W. Sawangngoenyuang, 'Foreign Banking: Do Countries' WTO Commitments Match Actual Practices?', WTO Staff Working Paper ERSD 2006–11 (October 2006); Aaditya Mattoo, 'Financial Services and the WTO: Liberalization in the Developing and Transition Economies', WTO Staff Working Paper No. TISD9803 (March 1998), World Trade Organization; Masamichi Kono and Ludger Schuknecht, 'Financial Services Trade, Capital Flows and Financial Stability', WTO Staff Working Paper No. ERAD-98-12, World Trade Organization.

7.2.1.1 Financial services

Article 5(a) of the Annex defines the financial services sector very broadly by stating that 'a financial service is any service of a financial nature offered by a financial service supplier of a Member'. Financial services include the following: all insurance and insurance-related services (direct insurance, reinsurance, and services auxiliary to insurance) as well as all banking services (ranging from 'traditional' banking activities such as acceptance of bank deposits, lending of all types, financial leasing, payments systems and guarantees to trading of negotiable instruments and financial assets, participation in issues of all kind of securities, money broking, asset management, settlement and clearing services for financial assets, and provision and transfer of financial information and data). In addition, all other auxiliary financial services (such as credit reference and analysis, investment and portfolio research and advice, and advice on acquisitions and on corporate restructuring and strategy) fall within the ambit of financial services.

7.2.1.2 Financial service supplier

'Financial service supplier' is also defined broadly by the Annex, including not only any natural or juridical person of a member supplying financial services but also any person of a member that 'wishes' to supply a financial service. On the other hand, a 'public entity', defined as including central banks or monetary authorities or private entities performing their functions, is not considered to be a financial service supplier under the GATS.

Not surprisingly, thus, certain highly relevant regulatory measures—which are essential for a thriving financial industry—are explicitly excluded from the scope of the GATS: activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies; activities forming part of a statutory system of social security or public retirement plans as well as all other activities conducted by a public entity for the account or with the guarantee of the government.

7.2.1.3. Prudential carve-out

Paragraph 2 of the Annex on Financial Services under the title 'Domestic Regulation' contains the so-called prudential carve-out[282] or prudential exception. Paragraph 2(a) explicitly allows members to take measures for prudential reasons, including for the protection of investors, depositors, and policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. A measure falling within the ambit of the carve-out may be as such incompatible with other GATS provisions, but justified and therefore legally permitted. In contrast to the general exceptions contained in GATS Article XIV, where only

[282] On the negotiating history of the prudential carve-out, its analysis, and rationale, see Juan Marchetti, 'The GATS Prudential Carve-Out' in Panagiotis Delimatsis and Nils Herger, eds., *Financial Regulation at the Crossroads: Implications for Supervision, Institutional Design and Trade* (Kluwer Law International, 2011) 279–95; Mamiko Yokoi-Arai, 'GATS' Prudential Carve Out in Financial Services and Its Relation with Prudential Regulation' (2008) *International & Comparative Law Quarterly* 57, 613–48.

'necessary' measures are allowed, the carve-out covers not only 'necessary' measures but also 'any' prudential measures. However, members are prohibited from using such measures as a means of avoiding their commitments or obligations under the GATS.

The Annex aims to liberalize trade in financial services; however, it does so in a balanced fashion.[283] The prudential carve-out ensures that other economic and societal objectives, such as consumer protection and financial stability can be protected. If the global financial crisis (GFC) has shown that this has not happened sufficiently in the past, it was certainly not the WTO parameters which limited the right sensibly to regulate the financial services industry.[284] Also, the GATS disciplines on financial services did not limit the response of the United States and EU Member States during the crisis.

Neither were bank bailouts—through direct and indirect recapitalizations and liquidity support measures—nor central bank financing—such as quantitative easing, nor the European Central Bank's long-term refinancing operation, asset-backed securities purchases, and other non-standard measures impeded by any of the GATS financial services disciplines. However, the prudential carve-out enables members not only to adopt measures in exceptional circumstances such as the GFC but also on a day-to-day basis, as part of prudent financial markets regulations.[285]

We are of the opinion that the current prudential carve-out would accommodate the new focus of central banks and regulators in addressing systemic risk in financial markets and institutions, and ensuring financial stability at large. This would include more pro-active and intrusive approaches to supervise individual firms and set stricter quantitative and qualitative requirements.[286]

7.2.2. The Understanding on Commitments in Financial Services

The Understanding on Commitments in Financial Services, included in the Final Act of the Uruguay Round, is not an integral part of the GATS. It uses a negative list approach, thus providing guidance for those members who wish to include them in their binding schedules of commitments. Members may therefore schedule specific commitments in the financial sector either in accordance with Part III of the GATS or in accordance with the Understanding. The rules and disciplines contained in the Understanding are only binding on those members that voluntarily adhere to it.

[283] Michael Hahn, 'WTO Rules on Trade in Financial Services: A Victory of Greed Over Reason?' in R. Grote and T. Marauhn, eds., *The Regulation of International Financial Markets—Perspectives for Reform* (Cambridge University Press, 2006) 176 *et seq*.

[284] Juan Marchetti, 'The GATS Prudential Carve-Out' in Panagiotis Delimatsis and Nils Herger, eds., *Financial Regulation at the Crossroads: Implications for Supervision, Institutional Design and Trade* (Kluwer Law International, 2011) 279, 285.

[285] Ibid. 290.

[286] cf. Pillar 2 of Basel III Additional discretion of supervisors to impose additional 'macro-prudential' capital charges. With the benefit of lessons learned in the aftermath of the GFC, banking supervisory authorities undertake to anticipate financial innovation in instruments, products, services, and structures and to impose controls accordingly (cf. MiFID II—product bans) and take a more robust approach to risk management, often based on stress tests.

Despite its lack of formal legal status within the GATS, some of the rules merit special attention because they reflect concepts that were promoted by major developed countries (the OECD approach) during the original negotiations. In several aspects the Understanding includes disciplines that go beyond those imposed by GATS Article VIII. It includes a standstill obligation, that is, the obligation of the members to include any existing monopoly rights in the financial services sector in their schedules. Members endeavour to eliminate such monopoly rights and commit to open government procurement of financial services. Furthermore, the Understanding provides for specific commitments for cross-border trade and consumption abroad,[287] commercial presence,[288] and temporary entry of personnel.[289] The Understanding also encompasses provisions for the supply of new financial services and processing of information. Finally, the Understanding requires members to endeavour to remove non-discriminatory regulatory measures; and to accord access on a national treatment basis to financial service suppliers of other members to payments and clearing systems operated by public entities, as well as to official funding and refinancing facilities available in the normal course of ordinary business. Moreover, it should be noted that regarding commitments undertaken pursuant to the Understanding, the member could adopt limitations or exceptions to existing non-complying measures but not to future measures.

At the time of writing, 119 members of the WTO have made commitments in the financial services sector pursuant to the GATS. More than thirty countries, mostly OECD countries, have signed the Understanding on Commitments in Financial Services.

Along with all services, financial services are included in the new services negotiations, which began in 2000. In 2001 the services negotiations were incorporated into the Doha/Millennium Round.[290] However, no results have been forthcoming. The ongoing negotiations of more than 20 members accounting for approximately three-quarters of world trade in services[291] are indicative of the degree of frustration with the state of play of the Doha negotiations.[292]

[287] Arts. 3 and 4 of the Understanding require members to allow foreign suppliers of financial services to supply services on a cross-border basis and also to allow their residents to purchase these services abroad.

[288] Arts. 5 and 6 of the Understanding provide for the right of establishment.

[289] Art. 9 of the Understanding requires members to permit temporary entry of certain personnel into their territory.

[290] cf. WTO Doc. S/L/93, Council for Trade in Services, *Guidelines and Procedures for the Negotiations on Trade in Services*, adopted by the Special Session of the Council for Trade in Services on 28 March 2001, 29 March 2001.

[291] Australia, Canada, Chile, Chinese Taipei (Taiwan), Colombia, Costa Rica, the European Union, Hong Kong, Iceland, Israel, Japan, Liechtenstein, Mauritius, Mexico, New Zealand, Norway, Pakistan, Panama, Paraguay, Peru, Republic of Korea, Switzerland, Turkey, the United States, and Uruguay. China has indicated its interest in joining the negotiations.

[292] cf. Juan Marchetti and Martin Roy, 'The TiSA Initiative: An Overview of Market Access Issues', WTO Staff Working Paper ERSD-2013-11 (27 November 2013); Rudolf Adlung, 'The Trade in Services Agreement (TISA) and Its Compatibility with GATS: An Assessment Based on Current Evidence', World Trade Review June 2015.

8. Conclusions

The GATS is the first comprehensive multilateral agreement establishing legal parameters for trade in services. It suffers from many deficiencies: for instance, the definition of the modes of supply is not optimal. The scope of the core provisions regarding specific commitments is unclear: where does Article VI stop and where does Article XVII start? The same is true for the relationship between these two provisions and Article XVI. And should we extend the scope of GATS Article XVII to cover subsidies as well? Subsequent Panel and Appellate Body jurisprudence is limited and has not yet created legal certainty as a result.

However, the importance of this treaty cannot be emphasized enough. It serves as a model for very ambitious FTA chapters on services. They all go further than the GATS, but can build on a solid and overall well-crafted document. The rather limited liberalizations achieved in the final phase of the Uruguay Round were already obvious in 1993. Nevertheless, the services industries worldwide strongly lobbied for this document, not so much because of its revolutionary content, but rather to create a strong framework for future negotiations and to integrate the services industry into the multilateral world of the WTO, including its dispute settlement mechanisms. These achievements looked important then. They remain important today, despite the fact that negotiations in a 161-member organization urgently need new ground rules.

17

Intellectual Property

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1. Introduction

The link between intellectual property and trade in the WTO calls for explanation.[1] Unlike most other Uruguay Round agreements, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement) is not an elaboration of a subject covered in the GATT 1947. In fact, the GATT is devoid of any mention of intellectual property (IP) rights.

Historically, the link between IP and trade was forged under the leadership of the United States.[2] After the close of the Tokyo Round in 1979, the United States became concerned and frustrated by the reluctance of developing countries to adopt high normative standards and strict enforcement measures for IP rights. Initiatives under the auspices of the World Intellectual Property Organization (WIPO) and the principal international conventions on IP came to no avail, so the United States successfully placed IP on the negotiating agenda for the Uruguay Round.[3] The linkage between IP and trade was based on two points. First, widespread piracy, counterfeiting, and infringement of IP rights constitute a barrier to trade in that the availability of such goods diminishes market access for legitimately traded goods. Second, trade and IP are intimately linked because of the importance of international IP rights transfer agreements. National regulation of such agreements is common and is generally of two types: (1) notification; and (2) registration and approval. US negotiators were concerned that burdensome registration and approval requirements in certain countries would inhibit investment and IP licensing and, therefore, trade.

Both of these points have merit, but acceptance of such arguments means that the benefits of linkage accrue primarily to developed countries. Thus, the negotiation of the TRIPs Agreement was primarily one between developed and developing countries of the GATT. The latter accepted the TRIPs Agreement somewhat reluctantly as part of the Uruguay Round package deal.[4]

Perhaps the strongest argument in favour of linking IP and trade is that linkage will facilitate technology transfer and therefore development in developing countries. Technology transfer and technology trade is growing; the increase of foreign direct investment (FDI) around the world has led to an unprecendented rate of technology transfer. Technology transfer and FDI are greatly facilitated by common international standards for IP.

The TRIPs Agreement,[5] which entered into force on 1 January 1995 along with the other WTO agreements, is largely an affirmation of the position of the industrialized world in the trade and IP debate. The TRIPs Agreement provides relatively high

[1] For a critical view of the trade and intellectual property link, see generally R. Michael Gadbaw, 'Intellectual Property and International Trade: Merger or Marriage of Convenience?' (1989) *Vand J. Transnat'l L.* 22, 223.

[2] See generally Daniel Gervais, *The TRIPS Agreement: Drafting History and Analysis* (London: Sweet & Maxwell, 1998).

[3] Paul Goldstein, *International Intellectual Property Law* (New York: Foundation Press, 2001) 110.

[4] Michael Trebilcock and Robert Howse, *The Regulation of International Trade*, 2nd edn. (London; New York: Routledge, 1999) 320–1.

[5] Agreement on Trade-Related Aspects of Intellectual Property Rights in WTO, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (UK: Cambridge University Press, 1999) 321.

minimum standards for each of the main categories of intellectual property rights, establishes standards of protection and enforcement, and provides for the application of the WTO dispute settlement mechanism to resolve disputes between WTO members. The TRIPs Agreement does not, however, resolve many issues resulting from different intellectual property regimes in different countries. For example, at the time TRIPs was concluded, the United States employed a first-to-invent criterion for priority in patent applications,[6] while the rest of the world used a first-to-file system.[7] This discrepancy was not harmonized under the TRIPs Agreement.

One of the first international agreements for the protection of intellectual property rights was the Paris Convention,[8] signed in 1883 and the subject of successive revisions. The Paris Convention requires national treatment, but lacks provisions for effective enforcement or dispute settlement. In the field of copyright, the Berne Convention[9] also lacks effective enforcement provisions.

The World Intellectual Property Organization (WIPO),[10] a specialized agency of the United Nations whose mandate is to promote the protection of intellectual property, administers the Paris and Berne Conventions and other intellectual property treaties. WIPO administers twenty-four intellectual property treaties,[11] including the following important agreements:

- The Madrid Agreement for the Repression of False and Deceptive Indications of Source on Goods,[12]
- The Madrid Agreement Concerning the International Registration of Marks,[13]
- The Madrid Agreement Protocol (for the further development of the international registration of marks),[14]
- The Patent Cooperation Treaty (for cooperation in the filing, searching, and examining of international applications for the protection of inventions where such protection is sought in several countries),[15]

[6] 35 U.S.C.A. § 102(g) (2001). In 2013, the United States enacted the America Invents Act, which changed American law to adopt the first-to-file sytem. 35 USC sec. 102 as amended.

[7] See Harold C. Wegner, 'TRIPS Boomerang: Obligations for Domestic Reform' (1996) *Vand. J. Transnat'l L.* 29, 535.

[8] Paris Convention for the Protection of Industrial Property, 20 March 1883, as last revised at Stockholm, 14 July 1967, 21 U.S.T. 1538 (hereinafter: Paris Convention).

[9] Berne Convention for the Protection of Literary and Artistic Works, 9 September 1886, as last revised at Paris, 24 July 1971 (amended 1979), 828 U.N.T.S. 221 (hereinafter: Berne Convention).

[10] Convention Establishing the World Intellectual Property Organization, 14 July 1967, 8 U.N.T.S. 3.

[11] The treaties administered by WIPO are available on the WIPO web page entitled Treaties and Contracting Parties, at <http://www.wipo.org/treaties/index.html>. A good general reference work is Frederick Abbott, Thomas Cottier, and Francis Gurry, *The International Intellectual Property System*, Parts One and Two (The Hague; Boston; London: Kluwer Law International, 1999).

[12] 14 April 1891, revised at Washington (1911), The Hague (1925), London (1934), and Lisbon (1958).

[13] Madrid Agreement Concerning the International Registration of Marks, 14 April 1891, 828 U.N.T.S. 389 (hereinafter: Madrid Agreement). States that are parties to the Madrid Agreement 'constitute a Special Union for the international registration of marks, known as the Madrid Union.' Ibid. Art 1. States that are parties to the Madrid Agreement Protocol are also members of the Madrid Union. See Madrid Agreement Protocol, n. 14, Art 1.

[14] Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks, 28 June 1989, WIPO Pub. No. 204(E) (hereinafter: Madrid Agreement Protocol).

[15] Patent Cooperation Treaty, 19 June 1970, amended 2 October 1979 and modified on 3 February 1984.

- The Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations,[16]
- The Washington Treaty on intellectual Property in Respect of Integrated Circuits,[17]
- The International Convention for the Protection of New Varieties of Plants (UPOV Convention),[18]
- The Locarno Agreement Establishing an International Classification for Industrial Designs,[19] and
- The Hague Agreement Concerning the International Deposit of Industrial Designs.[20]

A major weakness of WIPO, however, is that this agency lacks enforcement authority and power. Thus the WTO with its enforcement power through the dispute settlement mechanism was enlisted to play a major role in international IP through TRIPs.

2. Types of Intellectual Property Rights Addressed in the TRIPs Agreement

The TRIPs Agreement addresses seven categories of intellectual property rights: (1) copyright and related rights; (2) patents; (3) trademarks and service marks; (4) geographical indications; (5) undisclosed information or trade secrets; (6) industrial designs; and (7) layout designs of integrated circuits. There are overlaps between these categories. For example, a computer program may be patentable and is protected by copyright. It is useful, however, to keep in mind the general categories of IP rights. Because the moving force behind TRIPs was the United States, we will often refer to US laws as well as the international conventions that have shaped IP concepts.

Copyright protects the literary, musical, graphic, or other artistic form in which the author (the creator) expresses intellectual concepts. The key concept of copyright is originality. Copyright can extend to any tangible form, including literary works, dramas, pantomimes and choreography, pictorial, graphic and sculptural works, motion pictures and audiovisual works, musical works (including sound recordings),

[16] International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations, 26 October 1961, 12 U.S.T. 2377 (hereinafter: Rome Convention).

[17] Treaty on Intellectual Property in Respect of Integrated Circuits, 26 May 1989, 28 I.L.M. 1477 (1989) (hereinafter: Washington Treaty).

[18] International Convention for the Protection of New Varieties of Plants, 2 December 1961, 815 U.N.T.S. 89 (amended in 1972, 1978, and 1991) (hereinafter: UPOV Convention). Under a cooperation agreement between the International Union for the Protection of New Varieties of Plants (UPOV) and WIPO, the Director General of WIPO is the Secretary-General of UPOV. UPOV is derived from the French name of the organization: 'Union internationale pour la protection des obtentions végétales'. As of 7 December 2001, fifty states, including the EU Member States and the United States, were parties to the UPOV Convention.

[19] In force 27 April 1971. This provides a system of classifying designs to expedite novelty and infringement searches.

[20] 6 November 1925, revised 28 November 1960. This enables nationals of Hague Union member countries to make a single design deposit with the International Bureau of WIPO in Geneva to gain protection in all member countries.

and architectural works.[21] Copyright can also extend to computer programs as well. Copyright does not, however, extend to ideas or facts.[22]

Two concepts associated with copyright were developed in the civil law tradition and have made their way into the TRIPs Agreement. Civil law countries developed the concept of 'neighbouring rights' to extend privileges of copyright to creative works, such as sound recordings and radio and television broadcasts, that were not by individual authors.[23] The more pragmatic legal culture of the United States, a common law country, easily folds these rights into copyright without drawing this distinction, but the TRIPs Agreement contains a separate provision (Article 14) on neighbouring rights. Civil law countries also developed the concept of 'moral rights' of authors. Moral rights recognize that a work of art is an expression of the author's personality. Moral rights include the right of the artist to have his work associated with his name, the right that his work not be distorted or falsified, and the right to decide when and how to divulge his work to the public.[24] Moral rights were included in international law by the 1971 Berne Convention (Article 6*bis*). At US insistence, the TRIPs Agreement (Article 9.1) excludes recognition of these moral rights by excluding 'rights conferred under Article 6*bis*' of the Berne Convention.

In the past, many jurisdictions required either notice or registration as a prerequisite for copyright protection. For example, in the United States, notice was required. Notice was given by including the following on the form of expression: the symbol © or the word copyright (copr.) followed by the year of first publication and the name of the claimant. To adhere to the Berne Convention, the United States abolished the notice requirement for works published on or after 1 March 1989.[25] The Berne Convention is incorporated into TRIPs Article 9; thus, neither notice nor registration is needed to obtain copyright protection. The United States, like many WTO members, administers a voluntary copyright registration office.[26] As a practical matter, however, copyright notice and registration are still important in establishing and proving copyright.

Patent law protects inventions of all kinds; national laws require an 'invention' to be novel, useful, and non-obvious.[27] To encourage new inventions, patent laws typically grant the inventor a monopoly on commercial exploitation for a limited period. Patents can be granted for inventions categorized as machines, processes, compositions of matter, articles of manufacture, or new uses of any of these. In the United States, by decision of the Supreme Court, computer programs that involve mathematical formulae can be protected by patent.[28]

[21] For example, 17 U.S.C.A § 102(a) (1996 & Supp. 2001).
[22] For example, 17 U.S.C.A § 102(b) (1996 & Supp. 2001).
[23] Paul Goldstein, *Copyright's Highway: From Gutenberg to the Celestial Jukebox* (New York: Hill and Wang, 1994) 189–95.
[24] See Adolf Dietz, 'The Moral Right of the Author: Moral Rights and Civil Law Countries' (1995) *Columbia-VLA J.L. & Arts* 19, 199, 213–27.
[25] 17 U.S.C.A § 401 (1996 & Supp. 2001). [26] 17 U.S.C.A § 408 (1996 & Supp. 2001).
[27] See, for example, the U.S. Patent Law, 35 U.S.C.A § 100 *et seq*. TRIPs Art. 27 uses the European definition of patents as new, involving an inventive step, and being capable of industrial application.
[28] *Diamond v Diehr*, 450 U.S. 175 (1981). See also, for example, *State St. Bank & Trust Co. v Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed Cir. 1998) (holding that computer programs are patentable).

In all jurisdictions, patents are obtained by filing a patent application, and the right exists when the appropriate government office issues the patent. As a rule, patents are granted to the first person to file the patent application; this is known as the first-to-file system. Until 16 March 2013, the United States employed a first-to-invent system, granting the patent to the first person who could show discovery of the relevant invention, regardless of whether that person filed first. But in 2011, the United States enacted the America Invents Act,[29] which adopts a first-to-file system, but gives the first inventor a one-year grace period to file after public disclosure of the invention.

Patents are territorial, and a patent holder has rights only in the territory in which the patent was issued. To gain rights in other countries, the inventor must file a patent application in those countries under their laws. International conventions[30] help this application process by establishing principles of national treatment and non-discrimination for foreign applicants. Under the Paris Convention, an inventor obtains the benefit of the filing date in his home country provided he files in another convention country within one year of the home country filing date.[31] Under the Patent Cooperation Treaty, the inventor can file in multiple countries by one application and obtain the benefit of his home country's filing date.[32] In Europe, the European Patent Convention[33] created a European Patent Office to serve EU Member States, and one filing is sufficient to obtain patents in all EU countries.

Trademark law protects any word, name, symbol, logo, or device used to identify, distinguish, or indicate the source of goods or services. Trademark includes trade dress (the total image and overall appearance of a product) and product configuration (the shape, if non-functional). The purpose of this protection is to safeguard the integrity of products and to prevent product confusion and unfair competition (known as 'passing off').

In most countries, trademark rights arise through registration, on a first-come, first-served basis, and there is no requirement of prior use of the mark. In the United States, trademark rights arise under the common law through use of the mark, but protection is limited to the geographical area of the use.[34] Registration is also possible under state law, but protection is limited to the territory of the state or states involved.[35] Thus, the most practical alternative is to register the trademark under federal law, the Lanham Act, which allows the registered holder to identify the mark with the symbol ® or wording noting federal registration.[36] A trademark holder under the Lanham Act must file periodic affidavits of use of the mark; however, under Section 44 of the Act, a foreign mark may be registered in the United States without a showing of use.

[29] 35 U.S.C. § 102 *et seq*.
[30] The Paris Convention, n. 8, and the Patent Cooperation Treaty, n 15, are the principal international patent conventions.
[31] Paris Convention, n. 8, Art. 4.
[32] This must be followed up, however, by national application within thirty months in all Patent Cooperation Treaty countries in which patents were sought.
[33] European Patent Convention, 5 October 1973, T.S. No. 20 (1978), 13 I.L.M. 270 (1974).
[34] See Margreth Barrett, *Intellectual Property* (St. Paul, Minn.: West Group, 2001) 678–9.
[35] Richard Stim, *Intellectual Property: Patents, Trademarks and Copyrights*, 2nd edn. (Albany, NY: West/Thomson Learning, 2001) 268.
[36] 15 U.S.C.A. § 1051 *et seq*. (1997 & Supp. 2001).

Trademark rights are territorial. To obtain rights in other countries, separate applications must be filed. The Paris Convention aids the application process by giving priority to anyone in a convention country who files a foreign registration application within six months of filing in his home country. Moreover, in the EU, a single registration can be filed to gain a Community trademark valid in all EU countries. Another convention, the Madrid Agreement Protocol, allows a home country trademark office to forward an application to WIPO, which can issue an international registration for the mark.

Geographical indications are denominations that identify a good as originating in a region or locality, where the reputation or quality of the good is essentially attributable to its geographical origin. Whether protection should be afforded for *geographical indications* has provoked controversy. Many argue that geographical indications must be policed to prevent confusion and unfair competition. In the United States, however, geographical indications were long considered descriptive and, thus, not capable of trademark protection without proof they had acquired a secondary meaning. After the TRIPs Agreement, the United States amended the Lanham Act to outlaw false designation of origin,[37] and products bearing false indications can be barred from importation.[38]

Trade secrets, broadly defined, are information (such as a formula, pattern, compilation, program, method, technique, process, or device) that has economic value and with regard to which reasonable efforts are made to keep confidential. In most countries, trade secrets are not subject to registration but are protected through laws against unfair competition. In the United States, trade secrets are protected through common law and state statutes.[39] Trade secrets laws primarily protect against business espionage and disclosure of information by former employees.

Industrial design laws protect works of applied art that have industrial application, such as the design of a chair or a pair of running shoes. Many countries have separate registration systems for industrial design;[40] in the United States, the Design Patent Act[41] authorizes design patents for anyone 'who invents any new, original and ornamental design for an article of manufacture'.[42] The Hague Agreement Concerning the International Deposit of Industrial Designs authorizes nationals of member countries to make a single design application with the International Bureau of WIPO in Geneva in lieu of individual state application. The Locarno Agreement Establishing an International Classification for Industrial Design aids novelty and infringement searches by establishing an agreed system of classification for designs. The minimum term of protection under the TRIPs Agreement is ten years.[43]

Layout designs of integrated circuits refer to mask works (topographies) of integrated circuits, the stencils used to etch or encode an electrical circuit on a semiconductor

[37] 15 U.S.C.A. § 1125(a) (1997 & Supp. 2001). [38] 15 U.S.C.A. § 1124 (1997 & Supp. 2001).

[39] See the Uniform Trade Secrets Act, available at <http://hsi.org/Library/Espionage/usta.htm>.

[40] Goldstein, *International Intellectual Property Law* (2001), n. 3 at 552.

[41] 35 U.S.C.A. §§ 171–173. [42] 35 U.S.C.A. § 171. [43] TRIPs Art. 26.3.

chip. These are usually protected under copyright or under a special law.[44] The minimum term of protection under the TRIPs Agreement is ten years from the date of first commercial exploitation.[45]

3. Overview of the TRIPs Agreement

The question presents itself: given the existence of WIPO in Geneva and the multitude of longstanding international IP conventions, why was the TRIPs Agreement desirable or necessary?

Two considerations led to the creation of the TRIPs Agreement. First, the United States and other developed countries failed in their attempts to increase normative standards of protection for IP through WIPO and the Paris and Berne Conventions. Second, these two conventions leave enforcement of IP through judicial and administrative remedies to local decisions.

With the advent of globalization, higher standards of IP protection and international enforcement became increasingly important. Yet, IP enforcement is restricted to national territories. Even the United States, accustomed in certain fields such as antitrust to enforcing its laws extraterritorially,[46] has difficulty establishing extraterritorial enforcement of its IP laws.

In *Subafilms, Ltd. v MGM-Pathe Communications Co.*,[47] the US Court of Appeals for the Ninth Circuit held that acts occurring outside the United States do not constitute infringement under the US Copyright Act. In the field of patent law, the US Supreme Court in *Deepsouth Packing Co. v Laitram Corp.*[48] held that US patent laws do not extend to conduct abroad. In 1984, this holding was legislatively overruled,[49] but no case has arisen, largely because of the difficulty of obtaining personal jurisdiction. In trademark cases, the courts apply balancing tests to determine jurisdiction.[50] However, lack of subject matter jurisdiction will be the result in most cases.[51] Thus, as a rule, intellectual property rights holders are not able to rely on their home countries for international enforcement of their rights.

The TRIPs Agreement establishes rights and obligations between WTO members, not private individuals or firms. Nevertheless, it is crucially important for four reasons: (1) it establishes an international law of substantive minimum standards for national IP laws; (2) it establishes minimum international criteria for national enforcement of IP rights through civil, criminal, and administrative proceedings; (3) it subjects national

[44] In the United States, mask works are protected under the Semiconductor Chip Act of 1984, 17 U.S.C.A. § 901 *et seq.* (1996 & Supp 2001). This Act is administered by the US Copyright Office. The term of protection is ten years.

[45] TRIPs Art. 38.2.

[46] See Chapter 20, section 3.2.

[47] 24 F.3d 1088 (9th Cir. 1994) (*en banc*).

[48] 406 U.S. 518 (1972).

[49] 35 U.S.C.A. § 271(f).

[50] Compare, for example, *Steele v Bulova Watch Co.*, 344 U.S. 280 (1952) (holding that the Lanham Act applies extraterritorially if a defendant's conduct had a substantial effect on US commerce); *Nintendo of America, Inc. v Aeropower Co.*, 34 F.3d 246 (4th Cir. 1994) (holding that the Lanham Act applies to conduct abroad that has a significant effect on US commerce); *Wells Fargo & Co. v Wells Fargo Express Co.*, 556 F.2d 406 (9th Cir. 1977) (holding that the extraterritorial effect of the Lanham Act depends on principles of comity).

[51] *Wells Fargo*, ibid.

IP standards and enforcement to the WTO dispute settlement system, thereby providing an international forum for enforcement of rights and resolution of disputes; and (4) it establishes certain common procedural requirements that each national government must meet concerning the administration and maintenance of IP rights. TRIPs does not unify IP, but it stipulates a certain harmonization on a worldwide basis.

The TRIPs Agreement contains general non-discrimination obligations, most importantly a national treatment obligation for WTO members to afford nationals of all members the opportunity to protect IP rights to the same extent as a member's own nationals. There is also a most favoured nation (MFN) obligation to accord the same rights to nationals of all WTO members.

The TRIPs Agreement contains minimum substantive standards for IP protection for all of the categories of IP: copyright and neighbouring rights, patents, trademarks, geographical indications, trade secrets, industrial designs, and layout designs of integrated circuits. The TRIPs Agreement incorporates the substantive standards of IP conventions, such as the Berne Convention and the Paris Convention, but goes beyond them to establish even higher and more specific norms of protection for IP.

The TRIPs Agreement also sets out standards of enforcement of IP rights by foreign rights holders as well as national rights holders. Enforcement must be effective as well as fair and equitable. There must be judicial review of final administrative decisions. Civil and administrative enforcement procedures must conform to certain standards regarding matters such as evidence and proof and due process matters, and must offer a full range of remedies including injunctions and damages. Members must adopt border procedures that allow an IP rights holder to block the import of infringing goods. Parties must also provide appropriate criminal penalties for wilful violators of IP rights.

The TRIPs Agreement requires WTO members to establish an adequate IP office and procedures to facilitate the acquisition and maintenance of IP rights. Procedures for the grant and registration of IP rights must operate within reasonable periods, and the law must allow *inter partes* proceedings of opposition, revocation, and cancellation. Final administrative decisions must be subject to judicial review.

4. Institutional Arrangements

A Council for Trade-Related Aspects of Intellectual Property Rights is established to monitor the operation of the TRIPs Agreement.[52] The Council is composed of representatives of each of the WTO members, who meet regularly in Geneva. Each WTO member must make available to the Council, as well as to other WTO members on request, copies of its IP laws, regulations, judicial decisions, and administrative rulings. The Council monitors and reviews these laws, regulations, decisions, and rulings for each WTO member and may ask questions and demand answers.[53] The records of each review, including any questions and answers, are made available publicly on the WTO

[52] TRIPs Art. 68.

[53] See Adrian Otten, 'Implementation of the TRIPS Agreement and Prospects for Its Further Development' (1998) *J. Int'l Econ. L.* 1, 523–30.

website.[54] This review allows deficiencies to be identified and differing interpretations of the TRIPs Agreement to be identified and discussed.

The TRIPs Council cooperates fully with WIPO under a 1995 Cooperative Agreement between WIPO and the WTO.[55] There is a common register of IP laws and regulations, and the two organizations cooperate in these areas: (1) notification and translation of national laws and regulations; (2) communication of national emblems as called for by the Paris Convention; and (3) technical assistance.

The TRIPs Council is also charged with reviewing new developments and recommending modifications or amendment of the TRIPs Agreement itself.

5. Provisions Relating to Developing Countries

The TRIPs Agreement has several special provisions for developing country members. Developing countries and countries in the process of transformation to a market economy were given until 2000 to comply with the Agreement, four years more than developed country members.[56] In addition, if a developing country is required by the TRIPs Agreement to extend patent protection to new product and technology areas not previously covered by its IP laws, it could delay compliance until 1 January 2005.[57] Least developed country members[58] originally had until 2006 to comply with all of the TRIPs Agreement, with the exception of the general obligations of national treatment and MFN treatment.[59] With respect to pharmaceuticals, the 2006 deadline for least developed countries was extended to 1 January 2016 by the Doha Ministerial Conference.[60] With regard to other types of intellectual property, the 2006 deadline was extended to mid-2013, but even after that date, least developed country members may apply to the TRIPs Council for an extension of their compliance transition period.[61]

Developed country members are obligated to provide (1) incentives for transfer of technology to least developed countries;[62] and (2) technical assistance and financial help to developing countries in preparing laws and regulations on the protection and enforcement of IP rights.[63]

Even though developing countries benefit from certain grace periods for full compliance with the TRIPs Agreement, Article 70.8 and 70.9 require that they must establish an administrative means for preserving novelty and priority for patent

[54] <http://www.wto.org>.

[55] Agreement Between the World Intellectual Property Organization and the World Trade Organization (1995), reprinted in Paul Goldstein, ed., *International Legal Materials on Intellectual Property* (Foundation Press, 2002) 681. See Otten, 'Implementation of the TRIPS Agreement', n. 53 at 528.

[56] TRIPs Art. 65.2 and 65.3.

[57] Ibid. Art. 65.4.

[58] The WTO recognizes as least developed countries those countries that are designated as such by the United Nations. Forty-four least developed countries are recognized by the UN, of which thirty-one are members of the WTO.

[59] TRIPs Art. 66.

[60] WTO, Ministerial Conference, Fourth Session, Doha, 9–14 November 2001, *Declaration on the TRIPS Agreement and Public Health*, WT/MIN(01)/DEC/2, 20 November 2001, para. 7.

[61] Decision of the eighth WTO Ministerial Conference held in Geneva on 15–17 December 2011, <http://www.wto.org/decisions>.

[62] TRIPs Art. 66.2.

[63] Ibid. Art. 67.

applications during the transitional period.[64] They must also provide a system for granting exclusive marketing rights for such products.[65]

6. Public Policy Criticisms

There are six essential public policy criticisms of the TRIPs Agreement. All involve the relationship between developed and developing countries and issues fundamental to globalization:

1. Is the TRIPs Agreement a 'marriage of convenience'[66] between trade and IP to further exacerbate the divide between rich and poor countries? Are poor countries being forced to protect IP rights against their fundamental self-interest in order to serve the welfare of transnational businesses based in rich countries?
2. Does the TRIPs Agreement strike the right balance between mandating the patentablity of biotechnological inventions while excluding from patentability inventions that may contravene public policy concerns relating to human health and dignity and the integrity of the natural world?
3. Does the TRIPs Agreement, by ignoring the interests of poor countries, allow 'reverse piracy', that is, the appropriation by transnational companies in rich countries of valuable 'traditional knowledge' and cultural works, such as music, art, and dance, in poorer, less-developed societies?
4. Does the TRIPs Agreement undermine the UN Convention on Biological Diversity,[67] which specifies that people in developing countries have the right to control access to the biological resources within their borders?
5. Does the TRIPs Agreement endanger human health in poor countries by providing pharmaceutical companies in rich countries an IP monopoly over medicines essential to fight health crises and pandemics such as HIV? Such medicines are prohibitively expensive in poor countries.
6. Does the TRIPs Agreement threaten food production rich countries to gain IP rights over food plants and seeds, denying them to farmers in developing countries too poor to pay the prices demanded for them?

6.1 Benefits and costs of higher IP standards for developing countries

The first policy objection to the TRIPs Agreement, namely, benefits and costs of higher IP standards for developing countries, has a long history. Put as a general, abstract

[64] Appellate Body report, *India—Patent (US)*, WT/DS50/AB/R, para. 97. An identical complaint was filed by the EC, WT/DS79/R, para. 1.1.

[65] Appellate Body report, *India—Patents (US)*, para. 84. See also Panel report, *Indonesia—Autos*, para. 14.263 (in which Indonesia successfully defended its right to apply the grace period in TRIPs Art. 65.2).

[66] See Gadbaw, 'Intellectual Property and International Trade', n. 1 at 223–5.

[67] Convention on Biological Diversity, UNEP/Bio.Div./Conf./L.2, 22 June 1992, 31 I.L.M. 818 (1992).

proposition, a definitive answer is elusive.[68] The arguments pro and con must be carefully and objectively evaluated.[69]

The case against IP protection is that, simply put, for developing countries the costs of protection outweigh the benefits. This is the traditional view,[70] namely, that developing countries receive little or nothing for the price they pay in granting foreign monopolies over technology and industry within their borders. According to this view, IP rights stifle domestic innovation and impede the diffusion of technology in poor countries. Protecting IP means that using technology will involve higher prices and paying royalty payments to foreign companies. Why should a developing country spend administrative costs to process thousands of IP applications filed primarily by US, Japanese, and European companies? Patent statistics show that people from developing countries hold less than 1 per cent of patents.[71] These arguments hold that developing countries should offer only minimum protection to IP, should discriminate in favour of their own nationals, and should carefully scrutinize technology transfer agreements with foreign companies.[72]

In the 1970s, as part of the New International Economic Order,[73] developing countries sought an International Code of Conduct on the Transfer of Technology. This Code, the adoption of which was blocked primarily by the United States, would have affirmed the right of nations to review technology transfer contracts and object to restrictive clauses favouring transnational foreign companies.[74]

On the other side of the ledger, World Bank economists cogently expressed the case for increased protection for IP during the TRIPs negotiations: worldwide welfare suffers because of less than socially optimal R&D investment. Weak protection of IP in developing countries aggravates this problem.[75] Are there benefits for developing countries?

Several specific benefits may be argued, but their extent is hard to measure. First, there is evidence that IP protection will mean increased investment and technology transfer and diffusion in developing countries.[76] Second, IP protection will mean

[68] For an illuminating essay on the theoretical bases of protection, see A. Samuel Oddi, 'TRIPS: Natural Rights and a "Polite Form of Economic Imperialism"' (1996) *Vand. J. Transnat'l L.* 29, 415.

[69] See Alan S. Gutterman, 'The North–South Debate Regarding the Protection of Intellectual Property Rights' (1993) *Wake Forest L. Rev.* 28, 89.

[70] Edith Tilton Penrose, *The Economics of the International Patent System* (Baltimore: Johns Hopkins Press, 1951) 233.

[71] OECD, 'Economic Agreements for Protecting Intellectual Property Rights Effectively' (1989) TC WP (88) 21.

[72] Douglas F. Greer, 'The Case Against Patent Systems in Less-Developed Countries' (1973) *J. Int'l L. & Econ.* 8, 223.

[73] For a discussion of the New International Economic Order, see Chapter 19, section 9.

[74] Hans Peter Kunz-Hallstein, 'The United States Proposal for a GATT Agreement on Intellectual Property and the Paris Convention for the Protection of Intellectual Property' (1989) *Vand J. Trans. L.* 22, 265.

[75] Edwin Mansfield, 'Intellectual Property Rights, Technological Change and Economic Growth' in Walker and Bloomfield, eds., *Intellectual Property Rights of Capital Formation in the Next Decade* (Lanham: University Press of America, 1988) 29.

[76] Carlos Prima Braga, 'The Developing Country Case for and Against Intellectual Property Protection' in W. E. Siebeck, ed., *Strengthening Protection of Intellectual Property in Developing Countries* (Washington D.C.: World Bank, 1990) 69–87, 112.

increased investment, trade, and opportunity for capital formation.[77] Third, there will be positive benefits on a micro level in the form of training, the productivity of research, and international interactions with foreign business and universities.[78] Fourth, protection for IP may foster more creativity and 'an inventive habit of mind' in the population and, more specifically, in the workforce.[79]

Which side has the stronger case? In a very real sense this is now an academic question, for TRIPs represents the victory of those who believe in strengthened IP rights. The fact that developing countries, the majority in the WTO and even in the old GATT, were willing to accept TRIPs represents the trend, evident since the 1980s, in developing countries' willingness to accept a more liberal, less regulatory approach to international trade and investment.

Thus, the debate has shifted to identifying and dealing with problems, including social, economic, and environmental difficulties that developing countries may have in implementing TRIPs. Developing countries certainly need financial and technical assistance in setting up and operating IP offices. This is already a feature of TRIPs. Beyond this, TRIPs must be examined with a view to what possible new 'special and differential' treatment provisions are needed, if any.

6.2 Patentability

Patentability is important for the development of both beneficial biotechnologies and marketable environmental technologies that generate less waste and pollution. The TRIPs Agreement, by strengthening global intellectual property protection, will have a positive effect on both categories by providing incentives for research and development. Under the TRIPs Agreement, Article 27.1, patents must be available for both products and processes in all fields of technology. TRIPs Article 8.1 permits 'measures necessary to protect public health and nutrition, and to promote the public interest in sectors of vital importance to . . . socio-economic and technological development', but requires that such measures must be 'consistent with . . . this Agreement'. Thus, Article 8.1 cannot derogate from the patentability requirement of Article 27. Article 27.2 allows WTO members to exclude from patentability inventions that endanger human, animal, or plant life or health or the environment, but the exclusion must be 'necessary', not 'merely because the exploitation is prohibited by their law'.[80] Plants, animals, and essential biological processes may also be excluded from patentability, but micro-organisms, microbiological processes, and non-biological processes are patentable.[81]

This formulation assures that most biotechnological, pharmaceutical, and agricultural biotechnical inventions are patentable. Although naturally occurring plants and animals are not patentable, genetically modified micro-organisms and processes associated with reproducing animal genes, human DNA sequences, human proteins, and

[77] Ibid.

[78] Robert M. Sherwood, *Intellectual Property and International Development* (Coral Gables, FL: North–South Center, University of Miami, 1990) 138.

[79] Ibid. [80] TRIPs Art. 27.2. [81] TRIPs Art. 27.3(b).

human genes have all been patented in the United States and in Europe.[82] Although transgenic animals such as the 'Harvard mouse',[83] an experimental animal developed for the study of breast cancer, would not be patentable under the TRIPs Agreement, the transgenic process by which such animals are developed would be, either as a microbiological or non-biological process.

In 2013, the Supreme Court of the United States handed down a landmark ruling on the patentability of gene-related technology. In *Association for Molecular Pathology v Myriad Genetics, Inc.*,[84] the Court ruled that a naturally occurring DNA sequence is a product of nature and is not patent-eligible merely because it has been isolated. The Court based its ruling upon the implicit exception to patentability that holds that laws of nature, natural phenomena, and abstract ideas are not patentable.[85] The Court stated that the patent application in question did not include any method claims, and it also distinguished the *Diamond v Chakrabarty* case discussed earlier on the basis that in the *Myriad Genetics* case there was no inventive step that created something that did not exist in nature.[86] Consistent with this idea, the Court stated that the creation of a new DNA sequence that is not naturally occurring is patentable. Thus the Court upheld a patent for so-called cDNA (complementary DNA), which differs from naturally occurring DNA in that the non-coding regions in the molecule have been removed.[87]

The *Myriad Genetics* case clarifies the law of patentability of gene sequences in the United States. This ruling gives wide latitude to biotechnology patents involving method and processes as well as patents for gene sequences as long as the patent application discloses some small difference from a naturally occurring phenomenon. However, the America Invents Act of 2011, excludes patents for any invention directed to or encompassing human organisms.[88] Accordingly, patent applications involving biological material occurring in humans typically carve out and disclaim applying to patent the human organism aspect of their claims.[89]

It is evident, however, that patentability under TRIPs is very different from US law. TRIPs Article 27.3 broadly excludes from patentability 'diagnostic, therapeutic and surgical methods for the treatment of humans or animals.' Thus, international trade law involving biological processes and biotechnology allows WTO members to exclude from patentability a much wider range of subjects than is possible under US law.

[82] In *Diamond v Chakrabarty*, 447 U.S. 303 (1980), the US Supreme Court held that a genetically altered micro-organism was patentable under US law either as a 'manufacture' or a 'composition of matter'. For European patent cases, see Michael Bowman and Catherine Redgwell, *International Law and the Conservation of Biological Diversity* (London; Boston: Kluwer Law International, 1996) 171. The EU Directive on the Legal Protection of Biotechnology Inventions, 98/44/EC of 6 July 1998, O.J. 213/13 (1998) excludes 'essential biological processes' from patentability (Art. 2(2)). This term is defined to refer to biological processes consisting entirely of natural phenomena, such as crossing or selection without human intervention. This opens patentability to life processes and forms created through some act of human intervention.

[83] Genetically altered animals are patentable under US law. For example, the US Patent and Trademark Office issued US Patent No. 4,736,866 in 1988 to the inventors of a transgenic mouse with cancer-sensitive characteristics known as the 'Harvard mouse'. See Thomas Traian Moga, 'Transgenic Animals as Intellectual Property (or the Patented Mouse That Roared)' (1994) *J. Pat. & Trademark Off. Soc'y* 76, 511.

[84] 133 S. Ct. 2107 (2013). [85] Ibid. 2116. [86] Ibid. 2116–17. [87] Ibid. 2119.

[88] America Invents Act, Pub. L. No. 112-29, 125 Stat. 284 (2011), section 33.

[89] For example, *Ex Parte Kamrava* (PTAB 2012), APN 10/080, 177 (2012).

6.3 Protection of traditional knowledge and culture

Does the TRIPs Agreement adequately protect 'traditional knowledge and culture'? 'Traditional knowledge and culture' covers a lot of ground, ranging from knowledge that certain plants have health benefits, to stories, songs, music, dance, carvings, designs, pottery, sculpture, woodwork, mosaics, costumes, and metal ware—the list is endless.

Many developing nations have legislation defining and protecting 'folklore', an appellation for traditional knowledge and culture. Ghana defines folklore as 'all literary, artistic and scientific work belonging to the cultural heritage of Ghana which were created, preserved and developed by ethnic communities of Ghana or by unidentified Ghanaian authors'.[90] Similarly, Nigeria defines folklore as 'a group-oriented and tradition-based creation of groups of individuals reflecting the expectation of the community as an adequate expression of its cultural and social identity, its standards and values as transmitted orally, by imitation or by other means'.[91]

There seems to be a consensus in WIPO[92] and the TRIPs Council that TRIPs should contain protection for traditional knowledge, culture, and folklore.[93] The UN Convention on Biological Diversity already mandates protection for traditional knowledge associated with biological resources.[94] Yet, key issues remain regarding the manner and scope of such protection. First, should these items be protected in traditional IP categories or should a separate category be recognized? Second, folklore is often the creation of a group or an unknown (and forgotten) person or persons. Who should receive payment? How should the price be determined? Third, what should the scope of protection encompass? It appears that the rationale for protecting folklore is very different from that for other categories of IP. Unlike other IP, the rationale for protecting folklore would seem to be rooted in human rights. The scope of protection of folklore should be determined by precise identification of why protection is important. Careful consideration should also be given to whether too much protection would negate or stifle creativity and cultural expression.

Although paragraph 19 of the 2001 WTO Doha Ministerial Declaration charged the TRIPs Council with examining the relation between TRIPs and the protection of traditional knowledge, culture, and folklore under the UN Convention on Biological Diversity, no clear harmonization of the two agreements has been completed. A major disagreement exists over whether traditional knowledge should be affirmatively protected under TRIPs by adding it as a new *sui generis* category of protected intellectual property, on the one hand, or negatively protected by excluding traditional knowledge from patentability amending TRIPs Article 27, on the other. The former idea is

[90] Copyright Law (Ghana) § 53 (21 March 1985), as quoted in Paul Kuruk, 'Protecting Folklore under Modern Intellectual Property Regimes' (1999) *Am. Univ. L. Rev.* 48, 769, 778.

[91] Copyright Decree (Nigeria) § 28(5) (19 December 1988), as quoted in Kuruk, 'Protecting Folklore', ibid. 778.

[92] 'WTO Debates Geographical Indications, Traditional Knowledge', *Inside U.S. Trade*, 15 March 2002.

[93] Thomas Cottier, 'The Protection of Genetic Resources and Traditional Knowledge: Towards More Specific Rights and Obligations on World Trade Law' (1998) *J. Int'l Econ. L.* 1, 555, 581–4.

[94] Convention on Biological Diversity, n. 67, Arts. 8(j) and 10(c).

favoured by many developing countries but opposed by many developed WTO members on the grounds that rights holders and the contours of the right to traditional knowledge, culture, and folklore are difficult to define.[95] A second negotiating issue is how to prevent 'biopiracy' of traditional knowledge. The majority of WTO members favour a disclosure obligation under either TRIPs or WIPO (the Patent Cooperation Treaty) that would require all patent applicants to disclose the source or origin of genetic resources and traditional knowledge when they apply for patents. In addition, the patent applicant, as a condition to receiving a patent, would have to show prior, informed consent by the original source of the traditional knowledge or genetic resources. Presumably the necessity of showing prior, informed consent would mean that some compensation would accrue to the source of the traditional knowledge or genetic resources. However, this proposal is opposed by some WTO members, who argue that the matter of traditional knowledge can best be handled apart from TRIPs through traditional knowledge databases and private contract arrangements between patent applicants and countries where traditional knowledge is found.[96]

6.4 Biological diversity

The TRIPs Agreement guarantees recognition and enforcement of intellectual property rights backed by the authority of the WTO's dispute settlement mechanism. The Convention on Biological Diversity provides that the genetic resources of plants and animals are under the sovereignty of the state in which they are located, and developing countries have a right to benefit from the development of these resources as well as from the transfer of technology relevant to the development and use of genetic resources. These two agreements contain the seeds of potential conflicts[97] with vast implications not only for the environment, but also for the biotechnology, pharmaceutical, and agricultural industries.

The TRIPs Agreement and the Convention on Biological Diversity were developed, albeit at the same time, by different delegations, in different fora, with different objectives and with almost no consultation or communication between the two groups of negotiators. Even now, years after both negotiations have been completed, there has been little or no systematic analysis of the potential conflicts between the two agreements. Conflicts are most likely to arise between nations that have accepted both the Convention on Biological Diversity, which is in force and has been adopted by over 160 nations, and the WTO Agreement, which has been adopted by 144 states.

In the event of a dispute between parties to both agreements, the Convention on Biological Diversity adopts the following rule of priority:

[95] WTO TRIPs Document TN/C/W/368/Rev.1 (2006).

[96] WTO TRIPs Document TC/C/W/52 (2008). For details of this debate, see Daniel Gervais, 'TRIPS, Doha and Traditional Knowledge' (2010) *J. of World Intellectual Property* 13; Olufunmalayo B. Arewa, 'TRIPS and Traditional Knowledge, Local Communities, Local Knowledge, and Global Intellectual Property Frameworks' (2006) *Marquette Intellectual Property L. Rev.* 10, 156.

[97] See generally Graham Dutfield, *Intellectual Property Rights, Trade and Biodiversity* (London: Earthscan Publications, 2000).

> 1. The provisions of this Convention shall not affect the rights and obligations of any Contracting Party deriving from any existing international agreement, except where the exercise of those rights and obligations would cause a serious damage or threat to biological diversity.
>
> 2. Contracting Parties shall implement this Convention with respect to the marine environment consistently with the rights and obligations of States under the law of the sea.[98]

This 'serious damage or threat' standard is vague and difficult to apply because it is subject to interpretation. This flawed priority rule highlights the importance of dispute settlement when concrete issues arise.

6.4.1 Access to genetic resources

Industries such as biotechnology, pharmaceuticals, and agriculture are dependent on worldwide access to genetic resources. These and other industries use wild plants and animals in three basic ways. First, a natural species can be used directly as a source of natural chemicals or compounds for the production of drugs, or other products. An example is the use of the Pacific yew tree to produce an anti-cancer drug. Second, a natural species' chemical can provide information and ideas that can lead to the production of useful synthetic chemicals, drugs, or other products. An example is aspirin, a drug developed as a synthetic modification of salicylic acid, which is found in plants. Third, a natural species can be a source of a gene or genetic sequence that can be used to develop new varieties through breeding or a genetically modified organism through implantation. The former process is essential to modern agriculture. Because crops and animals are susceptible to disease and adverse climatic conditions, it is critical to have access to natural gene pools (germ plasm) to develop more productive and disease-resistant plants and animals. The latter process is critical to the biotech industry, which develops new products through genetic modification and incorporation of genetic materials.

Article 15 of the Convention on Biological Diversity authorizes states to limit or place conditions on access to genetic resources. How states will implement this provision is unclear, but the vague language of Article 15 could provide the basis for a range of actions, from an export ban to market pricing.

Although Article 15 itself is virtually open-ended in its authority, WTO members must observe GATT 1994 norms and the TRIPs Agreement in its implementation. Most notably, export bans or conditions must comply with GATT Article XX(g), which requires that export restrictions must relate to the conservation of the resource and must be applied in conjunction with restrictions on domestic production or consumption. In addition, under GATT Article XX(g), an export restriction must not employ 'arbitrary or unjustifiable discrimination between countries' or be a 'disguised restriction on international trade'. Article 15 is subject to the discipline of the GATT and the TRIPs Agreement.

[98] Convention on Biological Diversity, Art. 22.

The most notable exercise of Article 15 rights is the regime adopted by Costa Rica, which passed amendments to its Wildlife Conservation Law in 1992 declaring wildlife to be in the 'public interest' and requiring advance governmental approval for the export of genetic materials and for bio-genetic research.[99] This law was designed to give the Costa Rican government broad discretion in negotiating contracts with foreign firms that wish to employ genetic resources for research.

An example of the contractual regime Costa Rica is using to implement this policy is the 1989[100] contract signed by Merck & Company, the largest US pharmaceutical company, and the Instituto de Biodiversidad Nacional (INBIO), a non-profit institution created by the Costa Rican government. In this arrangement, Merck advanced $1 million to INBIO for the right to develop drugs from Costa Rican plants, insects, or microbes supplied by INBIO, and INBIO and the Costa Rican government agreed to share an amount, reportedly between 1 and 3 per cent, of the revenues from any products developed from INBIO-supplied genetic resources.

The TRIPs Agreement would not bar this arrangement or any other that requires compensation in the form of payment or royalties in return for resource use.[101] The TRIPs Agreement does not regulate pricing. Any payment arrangement would, therefore, be permissible. If, however, a state-trading enterprise is involved, GATT Article XVII requires that purchases and sales must be in accordance with commercial considerations and must be made on a non-discriminatory basis.[102] Thus, the TRIPs Agreement and Article 15 of the Convention on Biological Diversity are prima facie compatible.

A troublesome question likely to arise in legislation and contracts implementing Article 15 is whether countries may discriminate against foreign firms by charging them for resource use while exempting domestic firms. The answer depends on whether the charge is levied as a customs charge or an internal tax or charge. A true customs charge must comply only with the MFN requirement of GATT Article I, while an internal charge must comply not only with Article I, but also with GATT Article III, which requires national treatment.[103] In the latter case, it would be illegal under the GATT to exempt domestic firms. Thus, foreign firms that establish and carry on research activities in the country of origin of the biological materials could not be subjected to a discriminatory pricing arrangement.

While Article 15 is, in principle, compatible with the GATT and the TRIPs Agreement, it may be difficult for developing countries to derive substantial revenues from

[99] 'Costa Rica Strengthens Wildlife Protection Law', Envtl. Watch Latin Am., November 1992, available in Lexis, News Library, Zevl File.

[100] See Michele A. Powers, 'The United Nations Framework Convention on Biological Diversity: Will Biodiversity Preservation be Enhanced through Its Provisions Concerning Biotechnology Intellectual Property Rights?' (1993) *Wis. Int'l L. J.* 12, 103, 117–20.

[101] For a review and analysis of contractual arrangements, see Edgar J. Asebey and Jill D. Kempenaar, 'Biodiversity Prospecting: Fulfilling the Mandate of the Biodiversity Convention' (1995) *Vand. J. Transnat'l L.* 28, 703.

[102] GATT Art. XVII:1 and :2.

[103] It is not always easy to distinguish between a customs charge and an internal charge. Resolution of this issue can often only be made on a case-by-case basis considering the particular facts and circumstances involved.

Article 15 unless they illegally control exports and discriminate against foreign firms. First, only rarely will biological materials be limited to one country. Availability from multiple sources will reduce the price. For example, Eli Lilly Company produced two anti-cancer drugs (namely, vinblastine and vincristine) from periwinkle leaves first obtained in Madagascar. The periwinkle plant, however, grows wild in many areas of the world including Texas, where it is grown commercially. Although Eli Lilly has been criticized[104] for failing to compensate Madagascar, it is not difficult to see why it did not do so. Second, few new drugs or products are made from unmodified biological sources; more often they will be derivatives or produced purely synthetically.[105] Thus, Article 15 seems to be flawed as a mechanism for sustainable development.[106]

6.4.2 Transfer of technology

Perhaps the most difficult potential conflict between the TRIPs Agreement and the Convention on Biological Diversity concerns the transfer of technology. The TRIPs Agreement mandates a private, free-market system for the transfer of rights to intellectual property. Patent owners have the exclusive right to assign, transfer, or license their patents. The Convention on Biological Diversity, in contrast, requires that the contracting parties provide for (1) priority or concessional access for developing countries; (2) preferential terms for such countries; and (3) joint research and development efforts by firms that develop the intellectual property rights and the country supplying the genetic resources.[107]

All of these requirements potentially conflict with the TRIPs regime, which would leave matters to the private sector to decide without government interference. There appear to be two ways of dealing with this potential conflict. First, Articles 20 and 21 of the Convention on Biological Diversity provide for a 'financial mechanism' to facilitate transfer of technology to developing countries on favourable terms. Nothing in the TRIPs Agreement would prohibit the use of an international financial mechanism to assure access and the transfer of technology. Articles 15, 16, and 19 of the Convention can be interpreted to mean that transfer of technology should be left to negotiations between parties, supplemented where needed by the financial mechanism.

A second method available under the TRIPs Agreement to implement the Convention on Biological Diversity might be compulsory licensing. The Convention contains no specific authorization for compulsory licensing, but it does authorize 'legislative,

[104] See Richard Stone, 'The Biodiversity Treaty: Pandora's Box or Fair Deal?' (1992) *Science* 256, 1624.

[105] Office of Technology Assessment, US Cong., 'Biotechnology in a Global Economy' (1991) 75–6.

[106] Another arrangement to provide compensation to developing countries is being carried on by three US governmental agencies, the National Science Foundation, the Agency for International Development, and the National Institute of Health. These agencies encourage academic and commercial organizations in the United States to sign cooperative agreements with developing countries called International Cooperative Biodiversity Groups (ICBG), to inventory native species in the developing country to screen them for potential value, and to establish joint research and training. The arrangement typically provides for 'best efforts' to negotiate with a pharmaceutical company that may produce a drug commercially for a percentage of royalties to the developing country partner. See Karen Anne Goldman, 'Compensation for the Use of Biological Resources under the Convention on Biological Diversity: Compatibility of Conservation Measures and Competitiveness of Biotechnology Industry' (1994) *Law & Pol'y Int'l Bus.* 25, 695, 707.

[107] See Convention on Biological Diversity, Arts. 15(7), 16(2) and (3), and 19(1) and (2).

administrative or policy measures as appropriate'[108] to give developing countries access to technology. Compulsory licensing by WTO members would be controlled by the TRIPs Agreement, which has specific provisions on this issue. Article 30 of the TRIPs Agreement permits 'limited exceptions to the exclusive rights conferred by a patent, provided [the exceptions] do not unreasonably prejudice the legitimate interest of the patent owner . . .'. These conditions almost certainly would not apply to a technology transfer agreement. This leaves TRIPs Article 31, which authorizes compulsory licensing, subject to highly restrictive conditions that would seem impractical to achieve the aims of the Convention on Biological Diversity. Thus, amendment of the Convention, the TRIPs Agreement, or both, may be necessary to reconcile the two regimes.

6.4.3 The disclosure solution

A less drastic solution to the reconciliation of TRIPs and the Convention on Biological Diversity is to amend TRIPs to require all patent applicants to disclose the country of origin or the source of all genetic material used in the development of the new product or process for which they are applying for patent. Patent applicants would also be required to show prior, informed consent by the source of the genetic material as well as evidence of fair benefit sharing. This proposal, which is similar to the solution to protect traditional knowledge, is designed to incorporate the goals of the UN Convention on Biological Diversity in the context of TRIPs.[109]

6.5 Health and access to medicines

Goal 6 of the Millennium Development Goals adopted in 2000 by the United Nations General Assembly[110] commits the international community 'to combat HIV/AIDS, malaria, and other diseases'. The argument that the TRIPs Agreement blocks developing country access to medicine is a favourite of critics of the WTO.[111] Infectious diseases such as HIV/AIDS, tuberculosis, and malaria are the scourge of the developing world, but few people in developing countries have access to effective treatment at affordable prices.[112] Many blame this lack of access on the TRIPs Agreement.[113]

The claim that the TRIPs Agreement and the WTO are blocking access to medicines in poor countries is demonstrably false. There are enormous political, economic, and structural problems that must be solved to make such access a reality. The TRIPs Agreement is *not* the culprit, though it is an easy scapegoat because the real, underlying problems are hidden, complex, and perhaps intractable.

As a point of departure, the TRIPs Agreement and the WTO are *essential* to even begin to tackle health in the developing world. The TRIPs Agreement provides global

[108] Ibid. Arts. 15(4), 16(3), and 19(1).
[109] WTO TRIPS Doc. TN/C/W/52 of 19 July 2008.
[110] Text available at <http://www.un.org/millenniumgoals>.
[111] Lori Wallach and Michelle Sforza, *The WTO: Five Years of Reasons to Resist Corporate Globalization* (New York: Seven Stories Press, 1999) 48–9.
[112] 'A War Over Drugs and Patents', *Economist*, 10 March 2001, 43.
[113] For example, Wallach and Sforza, *The WTO* (1999), n. 111.

patentability, which is part of the solution because it gives private pharmaceutical companies an incentive to develop medicines for diseases in tropical and other developing areas. Of course, instruments of flexibility are needed, but the TRIPs Agreement is essential in this respect as well. Flexibility must not be random but must keep to rules. Rules create and fulfil expectations on all sides. The TRIPs Agreement provides the rules, which are essential to dealing with the problems.

At the 2001 WTO Ministerial Conference in Doha, the Declaration on the TRIPs Agreement and Public Health addressed health in developing countries in the following ways:

1. It affirmed the TRIPs Agreement and the importance of IP protection for the development of new medicines.
2. It agreed that the TRIPs Agreement does not and should not prevent members from taking action to protect public health.
3. It recognized the freedom of members to grant compulsory licences and determine the grounds for such licences.
4. It affirmed that each member has the right to determine what disease conditions constitute a national emergency under TRIPs Article 31(b).
5. It reaffirmed TRIPs Article 6, which allows each member to establish a regime for exhaustion of IP rights 'without challenge'.
6. It recognized that some developing nations cannot use compulsory licensing effectively and called on the TRIPs Council to 'find an expeditious solution' to this problem.
7. It agreed that least developed countries will not be obliged to comply with the patent and trade secret parts of TRIPs until 2016 at the earliest.

The Doha TRIPs Declaration requires the amendment of the TRIPs Agreement in certain respects, but the two techniques specifically affirmed by the TRIPs Declaration (namely, compulsory licensing and parallel imports) are flexibility measures already present in TRIPs without amendment. These measures can be used right away.

6.5.1 Compulsory licensing

TRIPs Article 31 permits a WTO member to pass a national law providing use of the subject matter of a patent without the authorization of the rights holder if certain conditions are met. Four of the Article 31 conditions are most relevant.

First, the proposed user must have made efforts to obtain authorization from the rights holder on 'reasonable commercial terms', and these efforts must have not been successful 'within a reasonable period of time'.[114] A member can waive this condition 'in the case of a national emergency'.[115] In the light of the Doha TRIPs Declaration, this

[114] TRIPs Agreement, Art. 31(b). [115] Ibid.

condition would seem easy to meet because that Declaration recognizes that each member 'has the right to determine what constitutes a national emergency'.[116]

Second, the scope and duration of the licence must be limited to the purpose for which it was authorized.[117] This condition, too, would seem easy to meet.

Third, the licence must be 'predominantly' for the supply of the member's domestic market.[118] This would be the case if the compulsory licence was to deal with the *member's* health crisis. This condition would present problems for parallel importing, which is discussed below.

Fourth, the rights holder must be paid 'adequate remuneration in the circumstances of each case, taking into account the economic value of the authorization'.[119] Although this condition presents some interpretative issues, it is flexible enough not to be an obstacle, especially in the light of the Doha Declaration.

A final issue is presented by TRIPs Article 27.1, which provides that 'patents shall be available and patent rights enjoyable without *discrimination* as to . . . the field of technology'. It may be argued that singling out pharmaceuticals is discriminatory. However, as Professor Fred Abbott has pointed out,[120] the WTO Panel in the *Canada—Generic Pharmaceuticals* case[121] read Article 27.1 flexibly, stating that it 'does not prohibit *bona fide* exceptions to deal with problems that may exist only in certain product areas'.[122]

6.5.2 Parallel imports

Another method available under the TRIPs Agreement for dealing with health crises in poor countries is parallel importing. Parallel importing is the term used for importing a legally produced product from a low-priced distributor instead of buying directly from the manufacturer. Parallel importing would enable a developing country to import needed medicines at the lowest world prices, bypassing authorized distributors. This tool is particularly useful for poor countries that have no capacity to build their own pharmaceutical plants to produce medicines under compulsory licences. Parallel importing allows such countries to import generic versions of patented drugs produced legally in countries like Brazil or India under compulsory licences. Thus, parallel importing must be combined with compulsory licensing to serve the poorest nations. The goods subject to parallel importing are known as 'grey market' goods because, while they are not counterfeit, they are sold without the authority of the IP owner.

The TRIPs Agreement allows parallel importing. Article 6 of the TRIPs Agreement states that exhaustion of intellectual property rights is a matter left to members to determine.[123] Exhaustion means that once a patented product has been sold anywhere

[116] See Doha Declaration, n. 60. [117] TRIPs Art. 31(c). [118] TRIPs Art. 31(f).

[119] TRIPs Art. 31(h).

[120] Frederick M. Abbot, 'The TRIPS-Legality of Measures Taken to Aldren Public Health Crises: A Synopsis' (2001) *Widener L. Symp. J.* 7, 71, 75–6.

[121] Panel report, *Canada—Pharmaceutical Patents*, WT/DS114/R, 7 April 2000.

[122] Ibid. para. 7.92.

[123] See Marco C. E. J. Bronckers, 'The Exhaustion of Patent Rights under World Trade Organization Law' (1998) *J. World Trade* 32(1), 137, 142.

under the authority of the patent holder, the patent holder has no right to prevent further sale or importation anywhere in the world.

WTO members deal with parallel importation in different ways. For example, in the United States parallel importation of patented goods generally is allowed,[124] but neither the Supreme Court nor the Court of Appeals for Federal Circuit, the two most important courts, have addressed the issue.[125] As for goods under trademark, parallel importation is allowed if the foreign authorized manufacturer and the domestic owner of the mark are under common control (parent, subsidiary, or sister corporation). If the foreign entity is independent and operating under licence of the trademark owner, parallel imports may be blocked.[126] Moreover, even goods sold by a foreign affiliate may be blocked on importation if they are different physically from domestic goods subject to the mark.[127] The status of parallel importation of goods subject to copyright is unclear.[128] In the EU, parallel imports are permitted freely throughout the territory of EU Member States as well as the European Economic Area (EEA).[129] The exhaustion principle operates, however, only as to goods sold within the EU and EEA, and Member States may block parallel imports from outside.[130]

The Doha Ministerial Declaration, as an official interpretation of Article 6, removes all doubt that parallel importing of pharmaceuticals is permitted under the TRIPs Agreement.[131]

There is, however, a problem with respect to combining compulsory licensing in country A with parallel importing by country B, which may be necessary to combat health crises in poor countries with no pharmaceutical industry.[132] TRIPs Article 31(f), as stated above, requires that a compulsory licensee produce the product 'predominantly' for the supply of its domestic market. This wording would permit some parallel exports, but not on a large scale. In response to this problem, on 30 August 2003, the Council for TRIPs, implementing the Doha accord, agreed to waive the obligations of paragraphs (f) and (h) of Article 31 of TRIPs for WTO members that declare a national health emergency and have insufficient manufacturing capacities for pharmaceutical

[124] *Curtiss Aeroplane & Motor Corp. v United Aircraft Eng'g Corp.*, 266 F. 71 (2d Cir. 1920).

[125] See Margreth Barrett, 'The United States' Doctrine of Exhaustion: Parallel Imports of Patented Goods' (2000) *N. Ky. L. Rev.* 27, 911.

[126] *K-Mart Corp. v Cartier, Inc.*, 486 U.S. 281 (1988).

[127] *Lever Brothers Co. v United States*, 981 F.2d 1330 (D.C. Cir. 1993); *Gamut Trading Co. v U.S. Int'l Trade Comm'n*, 200 F.3d 775 (Fed. Cir. 1999). In contrast, in the *Duracell* case, grey market goods were blocked by the US International Trade Commission under 19 U.S.C. § 1337 (Section 337 of the Trade Act of 1974), but President Reagan vetoed the ruling under § 1337(j). See Disapproval of the Determination of the United States International Trade Commission in Investigation No. 337–TA–165, Certain Alkaline Batteries, 50 Fed. Reg. 1655 (1985). There were no physical differences in this case. For a case in which grey market goods were successfully blocked under Section 337, see *Gamut Trading Co. v U.S. Int'l Trade Comm'n*, 200 F.3d 775 (Fed. Cir. 1999).

[128] See *Quality King Distributors, Inc. v L'Anza Research Int'l, Inc.*, 523 U.S. 135 (1998).

[129] Case 78/70, *Deutsche Grammophon Gesellschaft GMBH v Metro-SB-Grossmarkte GMBH & Co.* [1971] E.C.R. 487; Cases C-267–268/95 *Merck & Co. v Primecrown Ltd* [1996] E.C.R. I-6285.

[130] Case C-355/96, *Silhouette International Schmied GmbH v Hartlauer Handelsgesellschaft mbH* [1998] E.C.R. I-3682.

[131] Only the WTO Ministerial Conference and the General Council have the power to issue official interpretations of the TRIPs Agreement. WTO Agreement Art. XI:2.

[132] WTO, Ministerial Conference, Fourth Session, Doha, 9–14 November 2001, *Ministerial Declaration*, WT/MIN(01)/DEC/1, 20 November 2001, para. 6 (hereinafter: Doha Ministerial Declaration).

products.[133] This decision effectively allowed eligible developing countries caught up in a health crisis to import needed pharmaceutical products from countries producing them under a compulsory licence even without 'adequate' remuneration to the rights holder.

In December 2005 the TRIPs Council formally adopted an amendment to TRIPs, Article 31*bis*, which replaces the waiver with a permanent provision designed to facilitate access to essential medicines.[134] Paragraph 1 of Article 31*bis* specifies that TRIPs Article 31(f) 'shall not apply' to compulsory licensing 'to the extent necessary for the purpose of production of a pharmaceutical product(s) and to export [such product] to an eligible importing [WTO] member.' With respect to pharmaceutical trade, this provision effectively deletes the requirement of Article 31(f) that compulsory licensing may only be authorized 'predominantly' for the supply of the domestic market of a WTO member. The essential terms of this new arrangement are defined in an Annex to the TRIPs Agreement:

> *Pharmaceutical product* is any patented product needed to address public health concerns recognized in paragraph 1 of the 2001 Doha Ministerial Declaration on the TRIPS and Public Health.[135]
>
> *Eligible importing member* is any least-developed country member of the WTO and any other member who has notified the TRIPS Council of its intention to use the system set out in Article 31bis.[136]
>
> *Exporting member* is any member using the system to produce pharmaceutical products for export to any eligible importing member.[137]

The Annex to TRIPs contains several additional conditions that must be satisfied to come within the scope of Article 31*bis*, paragraph 1: the eligible importing member must notify the names and quantities of the products needed and must, if other than a least developed country, establish that it has insufficient manufacturing capacity in its pharmaceutical sector to produce the needed products. The exporting member must also notify the terms of the compulsory licence and the products involved.[138]

The most significant ambiguity in this system is the question of compensation due the patent holder. Article 31*bis* states that where a compulsory licence is granted by an exporting member, adequate compensation must be paid 'taking into account the economic value to the importing member.' But where the compulsory licence is granted by the eligible importing member, 'the obligation under Article 31(h) shall not apply.' The key to understanding this strange formulation appears to be the phrase 'economic value to the importing member.' If this is the case, the remuneration to the patent owner under Article 31*bis* is distinct from the remuneration due under Article 31(h). Whereas under the latter the standard for remuneration is the 'economic value of the authorization', under Article 31*bis* the standard is the 'economic value to the importing member.' Obviously these two measures may be quite different.

[133] Council for TRIPS, Decision of 30 August 2003, WT/L/540. Countries claiming the benefit of this waiver must report to the WTO on the names and expected quantities of the products needed.

[134] WTO Doc. WT/L/641 of 6 December 2005.

[135] Annex to the TRIPs Agreement para. 1(a). [136] Ibid. para. 1(b).

[137] Ibid. para. 1(c). [138] Ibid. para. 2.

Paragraph 3 of the Annex to TRIPs requires importing members to 'take reasonable measures' to prevent the re-exportation of pharmaceutical products imported under the Article 31*bis* system. Paragraph 4 of the Annex supplements this obligation by requiring all WTO members to take 'effective legal means' to prevent the importation of products produced under Article 31*bis* into their territories. Thus Article 31*bis* envisions and in fact authorizes a multi-tiered international pricing system for certain pharmaceutical products.

Somewhat inconsistently, Article 31*bis*, paragraph 3 authorizes limited international trade in pharmaceutical products produced under this system for the purpose of gaining economies of scale of production. Economies of scale are desirable in order to lower purchasing prices and to provide incentives for the creation of new pharmaceutical industries in the developing world. Accordingly international trade to realize economies of scale is permissible under two conditions: (1) the developing country seeking to utilize it must be a member of a WTO recognized regional trade agreement; and (2) at least half of the members of such trade agreement must be on the United Nations' list of developing countries. If these conditions obtain, either the producing or the importing member of an Article 31*bis* pharmaceutical may import or export the product to other developing country members of the regional trade agreement who share the public health problem in question.

Criticism of the Article 31*bis* system has come from multiple quarters. Some critics call the system ineffective and propose that it be simplified and expanded.[139] Criticism is levelled at the procedural complexities and the ad hoc, pharmaceutical-by-pharmaceutical, country-by-country, and case-by-case nature of the system.[140] Other critics question the expropriation of valuable property rights and argue that other policy instruments, such as aid from developed nations, should be used rather than eroding patent rights in the developing world.[141] There is also substantial doubt over whether the system is workable and whether the multi-tiered international pricing system for pharmaceuticals can be maintained. The TRIPs Council is charged with making annual reviews of this system.[142]

6.5.3 Beyond the TRIPS Agreement

Obviously, the TRIPs Agreement will not solve health problems in poor countries, but it should not stand in the way. Many elements are necessary for even a modicum of effective action. Funding by UN organizations and the World Bank is being solicited from member countries. This funding must be supplemented by two techniques that may involve WTO agreements: (1) subsidies; and (2) tiered pricing by pharmaceutical countries to make medicines available at lower prices in poor countries. The first may

[139] Mike Gumbel, 'Is Article 31B is Enough? The Need to Promote Economies of Scale in the International Compulsory Licensing System' (2008) *Temple Int'l and Comp. L. J.* 22, 161.

[140] Medicins sans Frontières, 'A Guide to the Post-2005 World: TRIPS, R&D, and Access to Medicines', available at <http://www.msf.org/msfinternational/invoke.cfm>.

[141] Alan O. Sykes, 'TRIPS, Pharmaceuticals, Developing Countries and the Doha Solution' (2002) *Chi. J. Int'l L.* 3, 47.

[142] Annex to the TRIPs Agreement, para. 7.

necessitate WTO action to amend the Agreement on Subsidies and Countervailing Measures (SCM), and the second may call for an exception from antidumping rules. Most difficult, however, will be establishing the necessary political will, training, education, and medical infrastructure in poor countries to do the job.[143] Of particular relevance is the work of the Global Fund for AIDS, Tuberculosis and Malaria, which is leading the international effort to combat these diseases in developing countries. At the time of writing, the Global Fund has disbursed over US$ 19.3 billion in 144 countries to support large-scale prevention, cure, and treatment programmes for these diseases.[144]

6.6 Food and farmers' rights

A concern particularly in developing countries is that, while TRIPs Article 27.3 broadly requires intellectual property protection for breeders of new varieties of plants and animals, no exception is made to allow farmers to reuse harvested seeds or animal material on their own farms. Thus farmers may not be able to use the seeds they harvest from their crops to resow in following years, nor can they breed patented animal varieties. The TRIPs Agreement lacks a 'farmers' privilege' that would allow such activities, although this right is a feature of many national intellectual property laws.[145]

The consequences of the lack of any 'farmer's privilege' exception to patentability is illustrated vividly by the case of *Bowman v Monsanto Co.*,[146] an opinion by the Supreme Court of the United States. In the *Bowman* case, a farmer who wanted to plant a second crop of soybeans purchased 'commodity soybeans' intended for human consumption from a grain elevator and planted them in his fields. In the event, most of these 'commodity soybeans' were genetically modified beans marketed by Monsanto, which filed suit against the farmer for patent infringement. The Court ruled in favour of Monsanto on the grounds that, although the sale of the patented beans by Monsanto gives rise to patent 'exhaustion', the exhaustion doctrine allows the purchaser to resell the soybeans or to consume them or feed them to animals, but does not include the right to make a 'copy' or to make a new product, which is the case if the patented beans are replanted to produce a new crop. US patent law, therefore, does not include any exception that allows a farmer to buy or save harvested seeds for replanting.[147]

Will IP rights protected by the TRIPs Agreement deny developing countries the seed stock necessary to grow their own food?

The TRIPs Agreement requires plant breeders' rights to be given worldwide IP rights protection. Although naturally occurring plants cannot be patented, the TRIPs Agreement provides that 'Members shall provide for the protection of plant varieties either

[143] A major tool in combating disease in developing countries is the Global Fund to Fight AIDS, Tuberculosis and Malaria, a private corporation based in Geneva. In April 2002, the Fund awarded $616 million to more than forty countries for prevention and treatment of the three diseases. David Brown, '$616 Million to Fight Scourges: Global Fund Awards Programs Treating AIDS, TB, Malaria' *Wash. Post*, 26 April 2002, A12.

[144] Global Fund Results Report (2010), available at <http://www.theglobalfund.org>.

[145] See Lionel Bently and Brad Sherman, *Intellectual Property Law*, 3rd edn. (Oxford: Oxford University Press, 2009) 568.

[146] 133 S. Ct. 1761 (2013). [147] Ibid. 1716.

by patents or by an effective *sui generis* system or by any combination thereof'.[148] The *sui generis* system refers to the UPOV Convention. States adhering to the UPOV Convention undertake to create a system of granting plant breeders' rights under their domestic laws. The TRIPs Agreement supplements the UPOV Convention by requiring all WTO members to grant IP rights status to plant breeders' rights, either through the UPOV Convention or by admitting their patentability.

Nevertheless, the TRIPs Agreement contains balancing provisions that may be sufficient to allow developing countries full access to food and seed resources. Article 8.1 allows members 'to protect public health and nutrition, and to promote the public interest in sectors of vital importance to their socio-economic and technological development'. However, the measures chosen under this provision must be consistent with the TRIPs Agreement.

Fortunately, the TRIPs Agreement provides two ways of securing seed supplies. First, under Article 27.2, members may exclude from patentability inventions 'necessary to protect human, animal or plant life or health'. A case that a particular exclusion is 'necessary' could be made on the basis of the *EC—Asbestos* ruling[149] and in the light of TRIPs Article 8.1. Second, Article 30 allows 'limited exceptions' to patent rights as long as these exceptions do not (1) unreasonably conflict with the normal exploitation of the patent; or (2) unreasonably prejudice the legitimate interests of the patent owner. It would seem that Article 30 might be invoked by developing countries to provide seed stock for family and small cooperative farming operations.

The Convention on Biological Diversity calls for respect and preservation of the knowledge, innovations, and practices of indigenous and local communities in developing countries.[150] Such knowledge, practices, and innovations should be explicitly recognized under the TRIPs Agreement and given IP protection. This recognition would further ensure that the TRIPs Agreement will not endanger food security or agricultural production in poor countries.

7. The General Principles of the TRIPs Agreement

7.1 The relationship between the TRIPs Agreement and other intellectual property treaties

The TRIPs Agreement provides that WTO members must respect the standards under the Paris Convention regardless of whether they are parties to the Paris Convention.[151] In addition, the TRIPs Agreement requires compliance with certain other multilateral conventions administered by WIPO.[152] The incorporation of WIPO conventions into the TRIPs Agreement subjects them to the TRIPs Agreement dispute settlement regime and allows WTO Panels to interpret WIPO conventions. This authority has the potential to create conflicts between WIPO and the WTO.

[148] TRIPs Art. 27.3(b). [149] Appellate Body report, *EC—Asbestos*, para. 172.
[150] Convention on Biological Diversity, Arts. 8(j) and 10(c). [151] TRIPs Art. 2.1.
[152] See TRIPs Arts. 1, 2, 3, 4, 5, 9, 10, 14, 15, 16, 22, 35, and 39.

7.2 Acquisition and maintenance of intellectual property rights

WTO members must create and operate governmental offices for the acquisition and maintenance of all forms of IP rights. Procedures for granting and registration of IP rights must be reasonable,[153] and a member's law must provide appropriate *inter partes* procedures, such as opposition, revocation, and cancellation.[154] Members may adopt measures to protect public health and the public interest that are consistent with TRIPs obligations.[155]

7.3 National treatment and most favoured nation treatment

WTO members must generally accord both national treatment and most favoured nation treatment to individuals and enterprises in connection with the acquisition, maintenance, and enforcement of IP rights.[156] This general rule is subject to exceptions recognized in existing international IP conventions.[157]

The national treatment provision of TRIPs is fortified by the national treatment provision of the Paris Convention, Article 2(1), which is incorporated into the TRIPs Agreement by TRIPs Article 2.1. Both of these national treatment Articles are closely related to GATT Article III:4, which requires national treatment with regard to 'all laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use' of any imported product.

In the *US*—Section 211 *Appropriation Act* case,[158] the WTO Appellate Body found two violations of both TRIPs Article 3.1 and the Paris Convention, Article 2(1). This case involved a US law designed to prevent trademark registration relating to any assets confiscated in the 1959 Cuban revolution without the consent of the original owner. National treatment violations occurred because (1) foreign nationals who were original trademark owners were subject to legal restrictions while US national original owners were not; and (2) foreign successors-in-interest to original owners were subject to two registration procedures while US successors-in-interest were subject only to one.[159]

In *EC—Trademarks and Geographical Indications (Australia)*,[160] the WTO Panel found violations of national treatment in the fact that the EC regulation on geographical indications specified different application, inspection, and objection procedures for EC nationals and nationals from other WTO members. The EC regulation also was found to impose conditions of reciprocity and equivalence on the availability of

[153] TRIPs Art. 62.1–62.2. [154] TRIPs Art. 62.4. [155] TRIPs Art. 8.1.

[156] TRIPs Arts. 3 and 4. In *US—Section 211 Appropriations Act*, the Appellate Body ruled that by not according protection to trademarks of businesses confiscated by the Cuban government, the United States was in violation of both of these obligations. Appellate Body report, *US—Section 211 Appropriations Act*, WT/DS176/AB/R.

[157] TRIPs Arts. 3.1, 4.1(a), (b), (c), and (d), and 5.

[158] Appellate Body report, WT/DS176/AB/R, adoption 1 February 2002.

[159] *US—Section 211 Appropriation Act*, paras. 233–68.

[160] Appellate Body report, *EC—Trademarks and Geographical Indications (Australia)*, WT/DS174/R, WT/DS290/R, adoption 20 April 2005.

protection for non-EC geographical indication claims. The Panel rejected arguments that these different procedures were not discriminatory and that the distinction was justified when the geographical indication was located outside the EC, and found violations of both TRIPs Article 3.1 and GATT Article III:4.[161] Violations of the Paris Convention national treatment article were deflected on the basis of 'judicial economy'.[162]

Four observations come to mind considering this case law: First, the national treatment comparison is made on the basis of a national group compared to a non-national group. Second, a national treatment violation may occur without explicit discrimination on the basis of nationality. Third, merely formal differences will produce a violation without a showing of actual discriminatory effect. Fourth, the three relevant national treatment provisions are similarly interpreted.

In the *US—Section 211 Appropriation Act* case the Appellate Body also found a violation of Article 4, the most favoured nation (MFN) provision of TRIPs because the law places Cuban-national owners under restriction while non-Cuban nationals were not.[163] Obviously such express discrimination will produce a violation. What is more important is the fact that Article 4 does not contain any exception such as GATT Article XXIV to justify more favourable treatment for free trade areas and customs unions without requiring the same favourable treatment for all. TRIPs Article 4 requires that 'any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of other Members.' Four exceptions to this requirement are (1) favours deriving from judicial assistance or law enforcement agreements of a general nature; (2) favours granted consistent with exceptions to national treatment in the Berne or Rome Conventions; (3) favours in respect of the rights of performers, producers of phonograms and broadcasting organizations; and (4) favours stemming from intellectual property agreements in force prior to the TRIPs. Thus it would appear that any WTO member can claim the benefit of favourable intellectual property treatment under any post-TRIPs regional or bilateral free trade or economic partnership agreement even if such provision is more favourable than the corresponding TRIPs provision.

8. Minimum Substantive Standards

The TRIPs Agreement provides minimum substantive standards that must be observed by all WTO members for each category of IP rights. The TRIPs Agreement contains minimum standards for the following categories of IP rights: (1) copyright and related rights; (2) patents; (3) trademarks (as well as service marks); (4) geographical indications; (5) undisclosed information or trade secrets; (6) industrial designs; and (7) layout designs of integrated circuits.

[161] WT/DS174, paras. 7.154–7.164; WT/DS290, paras. 7.104–7.114.
[162] WT/DS174, paras. 7.280–7.284; WT/DS290, paras. 7.244–7.248.
[163] Appellate Body report, WT/DS 176/AB/R, adoption 1 February 2002, paras. 308–16.

8.1 Copyright and related rights

The TRIPs Agreement requires WTO members to give full recognition to the copyright regime of the Berne Convention.[164] Computer programs must be copyrightable as literary works, as the term is used in the Berne Convention.[165] The minimum term of copyright protection must be fifty years from the end of the calendar year of making or publication.[166]

When the United States originally adhered to the Berne Convention in 1989, the US Congress adopted a minimalist approach to compliance with the terms of that Convention. The US Berne Convention Implementation Act[167] accorded no copyright protection for any work that was in the public domain in the United States, thus rejecting copyright protection for foreign works that were under copyright in their countries of origin at the time. This was done to favour US publishing houses who were able to escape paying royalties to foreign authors. However, in 1994 the US Congress passed the Uruguay Round Agreements Act, which included Section 514, which gave full copyright protection to pre-existing works of Berne member countries that were protected in their country of origin but lacked protection in the United States. Thus the United States is in compliance with the TRIPs mandate to implement fully the Berne Convention's first twenty-one Articles, except for the 'moral rights' provision of Berne Article 6*bis*.[168]

A limited exception to copyright protection is provided in TRIPs Article 13 for 'certain special cases which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the right holder'. Article 13 was narrowly interpreted in the *US—Section 110(5) Copyright Act*[169] case involving an exception in US copyright law to allow the playing of music by small retail establishments and restaurants. In this case the Panel interpreted TRIPs Article 13 to incorporate the 'minor exceptions' to copyright doctrine of the Berne Convention (Articles 11 and 11*bis*) into TRIPs.[170] The Panel further determined that TRIPs Article 13 contains three requirements: (1) the limitations or exceptions are confined to certain special cases; (2) they do not conflict with the normal exploitation of the work; and (3) they do not unreasonably prejudice the legitimate interests of the rights holder.[171] The US law exempted from copyright (1) 'homestyle' playing of audio/visual performances from a single receiving apparatus and (2) certain small business establishments that employ not more than four audiovisual devices. Applying the criteria of TRIPs Article 13 to these exemptions, the Panel ruled that the 'homestyle' exemption met the three criteria of Article 13 because the exemption was well defined and limited in scope.[172] However, the Panel ruled that the 'business exemption' failed all three criteria because the scope of potential users was open-ended and covered a potentially large number

[164] TRIPs Art. 9. [165] TRIPs Art. 10. [166] TRIPs Art. 12.

[167] 102 Stat. 2853 (1988).

[168] This provision of US law was upheld against constitutional attack in *Golan v Holder*, 132 S. Ct. 873 (2012).

[169] Panel report, *United States—Section 110(5) Copyright Act*, WT/DS160/R, adoption 27 July 2000.

[170] Ibid. paras. 6.42–6.70. [171] Ibid. paras. 6.75–6.91.

[172] Ibid. paras. 6.159, 6.219, and 6.272.

of facilities.[173] Therefore, the Panel ruled that the former exception was consistent and the latter exception was inconsistent with Berne Convention Articles 11 and 11*bis* as incorporated into TRIPs by TRIPs Article 9.1.[174] Subsequent to this decision, an arbitrator found that a reasonable time for implementation of this ruling was twelve months.[175] When this deadline was not met, a second arbitration found that the level of EC benefits being nullified or impaired as a result of Section 110(5)(B) of the US Copyright Act was €1,219,900 per year.[176]

In *China—Intellectual Property Rights*,[177] the Panel considered the issue of whether copyright extends to works that are subject to censorship or are prohibited under the law of a WTO member. Because TRIPs Article 9.1 incorporates the Berne Convention, the Panel applied that conventions standards to rule that, although Article 17 of Berne allows national censorship, Article 5.1 of the Convention requires that copyright be available for such works.

Developing countries criticize the TRIPs copyright system as being too broad and advocate that TRIPs be amended to include a defined list of public interest exceptions, an international 'fair use' exception, and a library exception.[178]

8.2 Patents

WTO members must extend patent protection to all inventions, whether products or processes, in all fields of technology.[179] The term of patent protection must be at least twenty years from the date of filing the application.[180] Moreover, patent rights must also be available without *discrimination* as to the place of invention, the field of technology, and whether products are imported or produced locally.[181] Three important derogations exist from these broad requirements: (1) exclusions; (2) limited exceptions; and (3) compulsory licensing.

8.2.1 Patent excludability

The TRIPs Agreement allows WTO members to exclude inventions from patentability on several grounds:

[173] Ibid. paras. 6.133, 6.211, and 6.266. [174] Ibid. para. 7.1.

[175] *US—Section 110(5) Copyright Act*, Recourse to Arbitration under DSU Article 21.3(c), WT/DS160/12 (2001).

[176] *US—Section 110(5) Copyright Act*, Recourse to Arbitration under DSU Article 25, WT/DS160/ARB25/1 (2001).

[177] Panel report, WT/DS362/R, para. 7.139, adopted 20 March 2009.

[178] Ruth L. Okediji, 'The International Copyright System: Limitations, Exceptions, and Public Interest Considerations for Developing Countries', UNCTAD International Centre for Trade and Sustainable Development, Issue Paper 17 (2006) 10–16, available at <http://www.iprsonline.org/unctadictsd/docs/ruth>.

[179] TRIPs Art. 27.

[180] TRIPs Art. 33. This rule was applied in Appellate Body report, *Canada—Patent Term*, WT/DS170/AB/R, adoption 12 October 2000 (holding that certain patents that pre-dated TRIPs are subject to twenty-year minimum term).

[181] TRIPs Art. 27.1.

1. inventions that are necessary 'to protect *ordre public* or morality, including to protect human, animal or plant life or health or to avoid serious prejudice to the environment . . . ';[182]
2. 'diagnostic, therapeutic and surgical methods from the treatment of humans or animals';[183]
3. 'plants and animals other than micro-organisms, and essentially biological processes for the production of plants or animals other than non-biological and microbiological processes'.[184]

None of these exclusions has been definitively interpreted, and the first and third exclusions are particularly ambiguous and thus susceptible to different interpretations. The first exclusion is potentially a broad exception to allow members to protect public health and the environment. The phrase '*ordre public*' indicates that this exclusion may even reach beyond these concerns to exclude inventions from patentability on political, cultural, and religious grounds. This exclusion is narrowed considerably, however, because of the additional requirement that the exclusion must be 'necessary' to prevent 'commercial exploitation' within a member's territory. A member relying on this provision may have to show that all commercial exploitation of the invention is harmful within its territory. This would be a rare case, indeed, and the exception would thus seem to be extremely narrow.

The third exclusion allows members to exclude animals and plants as well as biological processes for their production from patentability. This exclusion would seem to include even genetically altered animals and plants, which are patentable under the law of the United States.[185] This exclusion is, however, qualified by three exceptions: WTO members may patent (1) non-biological processes; (2) micro-organisms, and microbiological processes; and (3) plant varieties.[186]

8.2.2 Limited exceptions

Article 30 of the TRIPs Agreement allows 'limited exceptions' to the exclusive rights conferred by patent. Three requirements must be met to invoke this section.[187] First, the exception must be 'limited'. Second, it must not 'unreasonably conflict with normal exploitation of the patent'. Finally, it must not 'unreasonably prejudice the legitimate expectations of the patent owner'.[188] In the *Canada—Pharmaceutical Patents* case, the WTO Panel ruled that a provision allowing stockpiling of generic pharmaceuticals in anticipation of the expiration of the patent term could not be considered 'limited' because it was a 'substantial curtailment' of the patent holders' rights. On the other hand, an exception to allow regulatory review of the generic drug during the term of the patent so that the generic drug could be marketed quickly was held to meet the Article

[182] TRIPs Art. 27.2. [183] TRIPs Art. 27.3(a). [184] TRIPs Art. 27.3(b).

[185] *Diamond v Chakrabarty*, 447 U.S. 303 (1980).

[186] TRIPs Art. 27(b) 2. For plant varieties, a *sui generis* system such as the UPOV Convention is allowable.

[187] See Panel report, *Canada—Pharmaceutical Patents*, WT/DS114/R, adoption 7 April 2000.

[188] Ibid. para. 7.20.

30 requirements.[189] Curiously, however, the Panel ruled that this exception was invalid because it violated the non-discrimination requirement of Article 27.1, which the Panel held applied even to exceptions.[190] This ruling appears wrong on two grounds. First, the non-discrimination prohibition in Article 27.1 qualifies only that subsection by its terms, and there is no textual basis for transporting it to Article 30. Second, a limited exception, specifically allowed in Article 30, would by its very terms be discriminatory in some way; if it were not, it would not be *limited*.

8.2.3 Compulsory licensing

8.2.3.1 Differing views on compulsory licensing

In some countries, patent law provides for compulsory licensing under certain conditions. There are divergent views on the question of under what conditions there should be compulsory licensing of a patent. In the United States, the importance of intellectual property is emphasized, and compulsory licensing is done only in extreme situations, generally in cases of violations of the antitrust laws. Japan allows compulsory licensing under similar conditions, although these have never been invoked.

On the other hand, many developing countries take the view that compulsory licensing should be required if the public interest is injured due to an abuse of patent monopoly. For example, if a company that owns a patent in an area in which there is no competing technology deprives society of its benefit or unduly raises the price of the patented product, a national authority should be able to order compulsory licensing.

The problem boils down to whether the conditions under which compulsory licensing of a patent may be ordered should be indicated clearly by law or whether compulsory licensing may be ordered if doing so is justified and patent law should enumerate the conditions for such a licence. In the Uruguay Round trade negotiations that led to the conclusion of the TRIPs Agreement, advanced countries, such as the United States, took the former position, and the latter was asserted by developing countries, such as India.

8.2.3.2 Provisions in the TRIPs Agreement

In the Uruguay Round, the above issues were discussed and, as the result of negotiation, the TRIPs Agreement incorporates Article 31, which provides the requirements that must be met when ordering compulsory licensing. There are eleven principles listed in Article 31:

1. Whether ordering compulsory licensing shall be judged on a case-by-case basis.
2. When ordering compulsory licensing, there shall be consultation with the owner of the right in advance. However, compulsory licensing ordered for public and non-commercial use is exempted from this requirement.
3. The scope of the licence and its period shall be determined on the basis of the objective of compulsory licensing. With regard to technology relating to

[189] Ibid. para. 7.84. [190] Ibid. paras. 7.93–7.105.

semiconductors, compulsory licensing shall be given only for the purposes of utilizing public non-commercial use or the remedy for restrictive business practices.

4. Compulsory licensing shall be non-exclusive.
5. Rights derived from compulsory licensing cannot be transferred to a third party except for those cases in which the two parties jointly engage in business.
6. The purpose of compulsory licensing shall be, in principle, limited to the supply to the domestic market of the country concerned.
7. When the situation that led to the setting of compulsory licensing has ceased to exist and there is no likelihood of recurrence, the compulsory licensing shall be terminated, provided the legitimate benefit of the licensee shall be protected.
8. The owner of the right shall be given an appropriate compensation.
9. There shall be the opportunity for judicial review as regards the setting of compulsory licensing.
10. If a compulsory licence is ordered as a remedy to restrictive business practices, (2) and (6) above do not apply.
11. Where a compulsory license is given for exploiting a patent (the second patent), which cannot be exploited without infringing another patent (the first patent), the invention claimed in the second patent shall involve an important technical advance. The owner of the first patent is entitled to a cross-license on reasonable terms of the second patent and the authorized use for the first patent shall be non-assignable without including assignment of the second patent.

Issues of compulsory licensing of patents are those of balancing two opposing interests: namely, the interests of inventors and of technologically advanced countries and those of licensees and of technologically less advanced countries. Article 31 attempts to strike this balance. Nevertheless, many ambiguities and issues of interpretation remain.

8.2.4 Criticisms of the patentability Article of TRIPs

Criticism of TRIPs focuses particularly on Article 27, which in its simplicity very broadly requires patentability. Critics argue that this broad view of patentability ignores social considerations such as the necessity of a farmer's privilege to allow reuse of seeds, the recognition of traditional culture and knowledge, and access to medicines by the poor.[191] Intense criticism also concerns the patentability of certain biological materials, such as genes, genetic sequences, genetic material, and varieties of plants and animals. Under TRIPs, living things and biological material are patentable if they are created by intervention of man and not solely by a natural biological process. Thus, naturally occurring biological material such as gene sequences and isolated and

[191] These matters are addressed in separate sections of this chapter.

purified proteins may be patented if produced through some human agency. Critics argue that this broad patentability raises ethical questions and is not in the public interest. They question whether higher forms of life should be subject to patent, and argue that naturally occurring material, such as genes, should not be patentable simply on the basis that some human intervention technique was performed on them.[192] Defenders of broad patentability, on the other hand, argue that entire industries such as biotechnology depend on allowing patents to those companies and individuals who invest the time and money necessary to make new discoveries and to create new products.[193]

8.3 Trademarks and service marks

Trademarks and service marks must be given full protection by WTO members; however, registration may be made dependent on use.[194] The initial registration of a trademark shall be for a term of no less than seven years, and it must be renewable indefinitely.[195] If use is required to maintain registration, the mark may be cancelled only after an uninterrupted period of three years of non-use.[196] Trademarks are assignable and compulsory licensing of trademarks is not permitted.[197]

8.4 Geographical indications

WTO members must create a legal system of protection for geographical indications where the reputation or quality of a good is 'essentially attributable' to its geographical origin.[198] This is especially necessary for wines and spirits.[199] Negotiations are ongoing to determine the precise framework of protection for geographical indications.[200]

An example of geographic indications would be the use of the term 'Bordeaux', which indicates the name of a place in France and is associated with a high quality of wine produced therein. A wine producer in another country may use this name to promote the sale of its wine as 'Bordeaux-style wine'. The TRIPs Agreement allows WTO members to prohibit the use of geographic indications in such a way as to cause deception and provides for injunctive relief, the refusal of trademark registration, and invalidation of trademark registration when there is an authorized use of geographical indications causing deception. In addition, the TRIPs Agreement allows WTO members to prohibit the use of geographical indications with regard to wine and spirits even if they do not cause a deception.

[192] See, for example, Bolivia's intervention at the meeting of the TRIPs Council in March 2010, available at <http://www.laleva.org/eng/2010/03/bolivia>.

[193] Christopher Garrison, 'Exceptions to Patent Rights in Developing Countries', UNCTAD Project on IPRs and Sustainable Development (2006) 2–4.

[194] TRIPs Art. 15. [195] TRIPs Art. 18. [196] TRIPs Art. 19.1.

[197] TRIPs Art. 21. [198] TRIPs Art. 22. [199] TRIPs Art. 23.

[200] TRIPs Arts. 23.4 and 24. In the case Panel report, *EC—Trademarks and Geographical Indications*, WT/DS174/5; WT/DS290/R, 20 April 2005, the WTO Panel largely upheld the EU regulation on Geographical Indications in the face of a challenge by Australia and the United States.

8.5 Undisclosed information or trade secrets

WTO members must protect undisclosed information (or trade secrets). Undisclosed information that is secret and has commercial value is sometimes called 'know-how'. The requirements for being qualified as undisclosed information under the TRIPs Agreement are that it is a secret (that is, it is not in general circulation) and that it has commercial value. Primary examples include industrial know-how, which is undisclosed technology not patented but useful for industrial purposes and not in general circulation. The wording of provisions relating to undisclosed information does not exclude other types of undisclosed information such as know-how in marketing and distribution (for example, a list of customers).

8.6 Industrial designs

WTO members must provide IP protection for independently created industrial designs.[201] Design protection extends to aesthetic aspects not dictated by technical or functional considerations.[202] The duration of protection shall amount to at least ten years.[203] The owner of a protected design must have the right to prevent third parties from making, selling, or importing products bearing or embodying a design that is a copy of a protected design.[204]

8.7 Layout designs of integrated circuits

WTO members must give IP protection to layout designs (topographies) of integrated circuits (semi-conductor chips).[205] The minimum term of such protection must be ten years from the date of filing an application for registration or from the first commercial exploitation anywhere in the world.[206]

9. Enforcement of Intellectual Property Rights under the TRIPs Agreement

The TRIPs Agreement provides minimum standards for the enforcement of intellectual property rights. As explained in this section, these enforcement measures must include civil and administrative remedies, criminal remedies, and border (customs) measures.

9.1 General principles

WTO members must enact and maintain domestic laws and regulations that can deal effectively with infringements of intellectual property rights. The process of enforcement of intellectual property rights must be fair and equitable and not be unnecessarily

[201] TRIPs Art. 25.1. [202] TRIPs Art. 25.1. [203] TRIPs Art. 26.3.
[204] TRIPs Art. 26.1. [205] TRIPs Art. 35. [206] TRIPs Art. 38.1.

complex and expensive. The period of investigation should not be unduly limited or delayed. With regard to the administrative decisions, members must provide opportunities for judicial review concerning such decisions.[207]

9.2 Civil and administrative procedures and remedies

WTO members must provide for civil and administrative procedures for the enforcement of intellectual property rights to holders of such rights.[208] The United States was held to have violated Article 42 by denying protection for trademarks such as 'Havana Club Rum', linked with properties confiscated by the Castro government in Cuba.[209] Courts must be authorized to issue injunctive relief to stop infringement and order the payment of damages sustained by parties whose rights have been infringed.[210]

In *China—Intellectual Property Rights*,[211] the Panel examined TRIPs Article 46 in the light of Chinese law, which provided three options other than destruction for the disposal of infringing goods: donation to social welfare bodies, sale to the rights holder, and public auction. The Panel ruled that the existence of these three options did not mean that China could not also have the authority to destroy infringing goods.[212] The Panel also ruled that a Chinese law allowing the removal of an unlawfully affixed trademark as a remedy was inconsistent with the principles of Article 46.[213]

9.3 Criminal procedures

WTO members must impose criminal penalties on at least wilful infringement of trademark and copyrights committed on a commercial scale.[214]

The question of what is a 'commercial scale' was litigated in *China—Intellectual Property Rights*.[215] The Panel interpreted 'commercial scale' as focusing on the 'relative magnitude or extent [of those] engaged in buying and selling' and further stated that the concept of commercial scale is a relative standard which will vary with different fact situations.[216] The Panel ruled that the United States, which had challenged China's law that adopted varying thresholds for criminal prosecution dependent on the monetary value and the commodities involved, had not established that the Chinese law was inconsistent with TRIPs Article 61.[217] This interpretation appears to leave the question of 'commercial scale' up to the individual determination of WTO members.

9.4 Border measures

The TRIPs Agreement permits WTO members to exclude imports that infringe intellectual property rights.[218] With regard to trademark rights and copyrights,

[207] TRIPs Art. 41.1 and 41.2. [208] TRIPs Art. 42.
[209] Appellate Body report, *US—Section 211 Appropriations Act* (AB 2001–7), 2 January 2002, WT/DS176/AB/R.
[210] TRIPs Arts. 44, 45, and 46. [211] Panel report, WT/DS362/R, adopted 20 March 2009.
[212] Ibid. para. 7.355. [213] Ibid. para. 7.394. [214] TRIPs Art. 61.
[215] Panel report, WT/DS362/R, adopted 20 March 2009. [216] Ibid. paras. 7.532–7.602.
[217] Ibid. para. 7.669. [218] TRIPs Art. 51.

members must adopt procedures whereby a party can petition an administrative or judicial body for an injunction preventing an importation when it reasonably suspects that a product that infringes a trademark or copyright is being imported.[219] Members may adopt such a procedure in respect to the other intellectual property rights, such as patent rights, but are not obligated to do so.[220] The rationale is that, whereas an infringement of a trademark right and copyright is clear on the surface, whether an importation of a commodity infringes a patent cannot be determined until after detailed examination of the matter.[221]

In addition, it is provided that a claimant has the burden of proof that an imported article infringes its intellectual property rights.[222]

The United States has long had a procedure, Section 337 of the Tariff Act,[223] which allows the owner of an intellectual property right to petition the US International Trade Commission to obtain a cease and desist order and to exclude imports of goods that violate intellectual property laws.[224] In 1989, a GATT dispute settlement Panel ruled that Section 337 violated the national treatment provision (Article III:4) of the GATT.[225] After the Uruguay Round, the United States amended Section 337, ostensibly to correct the offending provisions.[226] Currently over 90 per cent of Section 337 cases involve patent infringement.[227]

Customs regulation has also been employed by the European Union to enforce IP rights. In 2008 and 2009, under the authority of Council Regulation (EC) No. 1383/2003, 2003 O.J. (L196/7), Dutch customs authorities seized and confiscated several shipments of generic pharmaceuticals made in India and exported through Europe to Brazil. As a result, both India and Brazil requested consultations with the EU at the WTO, alleging that the seizures violated TRIPs Articles 1, 2, 7, 8, 28, 31, 41, 42, 50 to 55, 58, and 59, as well as GATT Articles V and VI and WTO Decision of 2003 on the implementation of Paragraph 6 of the Doha Declaration.[228] In response, the EU issued a new border provision, Council Regulation No. 608/2013, effective 1 January 2014, that excludes goods that are only transiting EU territory.[229]

9.5 Provisional measures

Enforcement authorities of members can impose provisional measures to stop importation of a commodity when it determines that an importation of such a commodity infringes a right granted by law and there is urgency to take a prompt measure.

[219] TRIPs Art. 51. [220] TRIPs Art. 51. [221] TRIPs Art. 53.
[222] TRIPs Art. 52. [223] 19 U.S.C.A. § 1337 (1999 & Supp. 2001).
[224] For a recent application of this law, see *Ninestar Technology Co. Ltd, v International Trade Commission*, 667 F.3d 1373 (Fed. Cir. 2012).
[225] *US—Section 337 of the Tariff Act of 1930*, 7 November 1989, GATT B.I.S.D. (36th Supp.) at 345 (1990) (hereinafter: *US—Section 337*).
[226] For an argument that the amended section 337 violates TRIPs Art. 3, see N. David Palmeter, 'Section 337 and the WTO Agreements Still in Violation?' (1996) *World Competition* 20, 27.
[227] For example, see *Tessera, Inc. v International Trade Commission*, 646 F.3d 1357 (Fed. Cir. 2011).
[228] See section 6.5.
[229] See Melissa Blue Sky, 'Developing Countries and Intellectual Property Enforcement Measures: Improving Access to Medicines through WTO Dispute Settlement' (2011) *Trade, Law and Development* 3, 407.

9.6 Dispute settlement

The dispute settlement process, as provided for in the Dispute Settlement Understanding (DSU) of the WTO Agreement, applies to the settlement of disputes arising under the TRIPs Agreement.[230]

Non-violation complaints could not be brought under the TRIPs Agreement until 2000,[231] and the Doha Ministerial Conference as well as subsequent ministerial meetings have extended this moratorium.[232]

10. Exhaustion of Intellectual Property Rights

There are two competing theories of exhaustion of intellectual property rights. Under the universal or international exhaustion theory, an IP rights holder's rights are exhausted on the first sale of the protected product anywhere in the world. Under this theory, the protected product can be resold and even exported to or imported into other countries where the original rights holder has a protected interest. Under the domestic or territorial exhaustion theory, however, the rights holder's IP rights are not exhausted until after the first sale of the product in the territory in which he holds the rights. Under this theory, the rights holder can prevent the export or import of the protected product. Thus, 'parallel' or 'grey market' imports—the sale of a legally produced product in a different territorial market—are allowed under the international exhaustion theory but prohibited under the domestic exhaustion theory. Furthermore, different exhaustion theories may be applicable to different forms of IP; thus, parallel imports of patented products may be prohibited, while parallel imports of trademarked products are permitted.

In the negotiation of the TRIPs Agreement, the parties were unable to reach agreement on the issue of exhaustion. This disagreement is reflected in TRIPs Article 6: 'For the purposes of dispute settlement under this Agreement, subject to the provisions of Article 3 and 4, nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights'.[233] The international exhaustion doctrine is, therefore, outside the scope of the TRIPs Agreement. Thus, the resolution of exhaustion issues is left to national laws. There are no international or customary law norms in this area. The various positions of WTO members differ widely. At the Doha Ministerial Conference in 2001, the members reaffirmed that each member is free to establish its own regime on exhaustion.[234]

11. Restrictive Business Practices

11.1 Types of restrictive business practices involved in technology licensing agreements

International technology licensing often takes the form of a patent or know-how licensing agreement. When a firm owns a patent covering a certain area of production

[230] TRIPs Art. 64.1. [231] TRIPs Art. 64.2 and 64.3.

[232] WTO, Ministerial Conference, Fourth Session, Doha, 9–14 November 2001, *Implementation-Related Issues and Concerns*, WT/MIN(01)/DEC/17, 20 November 2001, para. 11.1.

[233] TRIPs Art. 6. [234] Doha Ministerial Declaration, para. 5(d).

in a country and grants a licence to another firm, the technology incorporated into the patent is transferred. If the patent owner is a foreign firm and the licensee a domestic firm, the licensing agreement provides for international transfer of technology. The same applies to a licensing agreement of know-how.

Restrictive conditions are often attached to a patent or know-how agreement whereby the licensee is prevented from engaging in certain activities. Some examples follow with respect to patent licensing agreements:

1. The licensor may require the licensee to observe a minimum price when it sells the product produced using the licensed patent.
2. The licensor may require the licensee to purchase parts and components necessary to produce a product covered by the patent from the licensor or a party designated by the licensor.
3. The licensor may require the licensee not to handle a commodity that competes with the product covered by the licensed patent.
4. The licensor may require the licensee not to engage in the research and development of a competing product during the period of the licence.

The above are but a few of many examples of restrictive business covenants incorporated into patent or know-how licensing agreements. Some restrictive covenants are necessary and reasonable for protecting the interests of the licensor. For example, it is legitimate for a licensor of a patent to limit the field of use of the patent that the licensee can exploit. Other restrictive covenants may be excessively restrictive and deprive licensees of the benefit they are entitled to enjoy. For example, if a licensor of a patent requires that a licensee must transfer to the former any improvement technology that it develops on the basis of the licensed technology, the licensee is deprived of any incentive to develop new technology.

Different countries have different attitudes to restrictive conditions attached to patent or know-how licensing agreements. In many countries, restrictive conditions are regarded as issues of competition law or foreign investment law. The United States generally takes a lenient attitude to conditions attached to licensing agreements,[235] whereas the European Community and Japan take a more stringent attitude to them. Developing countries are generally critical of restrictive conditions attached to patent or know-how licensing agreements because, in many cases, an enterprise of an advanced country imposes such conditions on an enterprise of a developing country that licenses the intellectual property.

11.2 Article 40 of the TRIPs Agreement

Article 40.1 of the TRIPs Agreement recognizes that some licensing practices or conditions pertaining to intellectual property rights that restrain competition[236] may

[235] Patent misuse is narrowly construed in the United States. See *Princo Corp. v International Trade Commssion*, 616 F. 3d 1318 (Fed. Cir. 2010).

[236] The Supreme Court of the United States has recognized that some business agreements, such as a settlement agreement between a pharmaceutical patent holder and a generic drug manufacturer under

have adverse effects on trade and may impede the transfer and dissemination of technology. The TRIPs Agreement specifies only three examples of licensing practices or conditions that restrain competition and allows WTO members to enact domestic legislation on restrictive business practices incorporated in licensing arrangements. Licensing practices or conditions listed in TRIPs Article 40.2 as examples of those that restrain competition are: (1) exclusive grant back conditions; (2) conditions preventing challenges to validity; and (3) coercive package licensing. This is an illustrative, not an exhaustive list.

In exclusive grant back conditions, the licensor of technology requires that the licensee must grant back an improvement technology that the latter has developed on the basis of the licensed technology. This grant back may take the form of transfer of rights, such as a transfer of patent on this improvement technology or of an exclusive licence to be given to the former whereby everyone except the former is excluded from utilizing this technology. An exclusive grant back (or assign back) of improvement technology is regarded as an unfair business practice in some jurisdictions, such as the European Community, where this is a prohibited practice, and Japan, where the guidelines designate this as an unfair business practice.

Conditions preventing challenges to validity sometimes are referred to as 'non-contestability clauses', which means that the licensee of the patent cannot challenge the validity of the licensed patent. Although, in the United States a non-contestability clause is regarded as not enforceable, there are jurisdictions, including the European Community, in which a non-contestability clause is regarded as being not necessarily an unfair business practice. The rationale behind the inclusion of this category in Article 40.2 is not clear.

A coercive package licensing agreement generally is regarded as unlawful as long as a package licensing is imposed on the licensee in the major jurisdictions. However, a package licensing may be reasonable if patents or know-how combined in the package are inextricably linked with each other or the combination of those patents or know-how guarantees the effective use of technology. This suggests that a judgement must be made on a case-by-case basis.

It should be observed that these three types of restrictive business practices are by no means representative of conditions in licensing agreements which hinder free flows of technology, and the rationale behind the inclusion of only those three categories in TRIPs Article 40.2, even as examples, is not clear. Therefore, the scope of legislation which members enact to combat restrictive business practices incorporated in licensing agreements should be greater. It is desirable that Article 40.2 be modified to include more practices or guidelines to indicate what practices may fall under such legislation.

12. Conclusions

The TRIPs Agreement is a highly innovative document that breaks new ground in covering a field tangentially related to international trade that is not covered in the

which the generic drug maker receives payment not to manufacture the generic drug is not immune from antitrust attack. *Federal Trade Commission v Activis, Inc.*, 133 S. Ct. 2223 (2013).

GATT 1994. Overall, the TRIPs Agreement has worked well, and the WTO has established a working relationship with WIPO to upgrade significantly intellectual property rights protection around the world.

In the coming years, WTO members must continue to implement the wide-ranging provisions of the TRIPs Agreement. Significant public policy questions have arisen with regard to the TRIPs Agreement that must be addressed in the future. The Ministerial Declaration adopted at Doha, Qatar in 2001 has signalled that the TRIPs may be significantly modified.

18

Government Procurement

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1. The Government Procurement Agreement as a Plurilateral Agreement

WTO rules on government procurement are contained in the Government Procurement Agreement which is a plurilateral agreement. Government procurement plays an important role in the economies of WTO members.[1] There are divergent views on government procurement among WTO members with regard to how open this sector should be to foreign commodities and services. Some developing country members

[1] In most countries, government procurement accounts for 15–20 per cent of GDP. In the European Union (EU), it accounts for 17 per cent of GDP, and in India, it accounts for about 39 per cent of GDP. In normal terms, the covered procurement markets of some key parties have grown by up to 300 per cent over a ten-year period to 2006–07. See WTO, Ministerial Conference, Briefing note: Government Procurement Agreement (GPA), 3–4, <http://www.wto.org/english/thewto_e/minist_e/brief_gpa/e.htm>.

regard government procurement as an important market for the domestic industries and are reluctant to open this sector to foreign commodities and enterprises. Even among developed country members, there are different opinions on the question of how much this sector should be open to foreign commodities and enterprises. We have seen instances in history when developed countries resorted to 'buy national policies' when the economy slowed down. In light of this situation, the framers of WTO agreements decided to put government procurement into Annex 4 of the Marrakesh Agreement (the Plurilateral Agreement) under which WTO members have the option of whether to join it or not.

Government procurement is a set of activities of governments to procure goods and services by purchase, lease, and other means. This also involves construction of buildings and other facilities by governments. In many countries, the amount of procurement by governments of goods and services is very large. As government activity expands, the amount of government procurement increases also. Indeed, in major countries, the amount of government procurement accounts for a substantial part of the total GDP.[2] It is of great concern to foreign suppliers whether or not government procurement is open to foreign products, services, and foreign enterprises as well as to domestic products, services, and enterprises.[3]

Some countries use government procurement to promote domestic industries and protect national security. For such purposes, some countries promote a 'buy national product policy',[4] give preference to domestic products and services, and exclude or limit access by foreign products, services, and enterprises to the government procurement market of the country. Such restrictive procurement policies are based on considerations such as, inter alia, (a) protection and promotion of domestic products and industries vis-à-vis competition by foreign products and enterprises, (b) promotion of small business in the country, (c) promotion of underdeveloped regions in the country, and (d) protection of national security. Especially in military and defence procurement, the incentive to prefer domestic enterprises is strong. Sometimes foreign products and enterprises are totally excluded from the procurement market of a country. Sometimes domestic products and enterprises are given preference in the bidding process to such an extent that a domestic product or enterprise is preferred even if the bid price offered by the domestic enterprise is higher than that of foreign competitors.

However, an emphasis on domestic preference in government procurement tends to stifle competition between domestic and foreign enterprises, raise procurement costs, and reduce incentives on the part of protected domestic industries to make improvements and innovations to increase efficiency. Even if preference is given to domestic products for

[2] See n. 1.

[3] For detailed accounts of government procurement issues, see Sue Arrowsmith and Robert D. Anderson, eds., *The WTO Regime on Government Procurement* (Cambridge University Press, 2011); Bernard Hoekman and Petros C. Mavroidis, eds., *Law and Policy in Public Purchasing* (University of Michigan Press, 1997). For recent literature, see Peter Trepte, 'The Agreement on Government Procurement' in Patrick F. J. Macrory, Arthur E. Appleton, and Michael Plummer, eds., *The World Trade Organization: Legal, Economic and Political Analysis*, Vol. I (Springer, 2005) 1124–63.

[4] There is a detailed review of practices of trading nations in government procurement in: *2004 Report on the WTO Consistency of Trade Policies by Major Trading Partners*, Industrial Structure Council, METI, Japan (2004), 383 *et seq*.

the purpose of promoting a domestic industry, an increase of costs to the government and its detrimental effect to the economy as a whole may outweigh whatever advantages the preferred industries may enjoy. Also such restrictive policies have adverse impacts on an international open trading system. Since government procurement has come to play such a significant role in the economy, the open trading system needs a set of international rules on government. Therefore, as will be explained, the WTO adopted an agreement on government procurement which incorporates the principles of open market access and non-discrimination in government procurement.

2. The Background of the Government Procurement Agreement

2.1 A brief history

GATT 1947 Article III provided for the principle of national treatment (NT). However, due to the peculiar features of government procurement, it allowed an exception to this principle in Article III:8(a) which provided 'The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.' Article III:8(b) further provided that 'The provisions of this Article shall not prevent the payment of . . . subsidies effected through governmental purchases of domestic products.' Therefore, GATT 1947 Article III permitted the preferential procurement of domestic products if such procurement was for governmental purposes. Also it allowed governments to give subsidies to domestic industries, especially to small businesses, by way of government procurement.

GATT 1947 Article XVII:1 provided for the national treatment and non-discrimination principle with respect to state-trading by providing that contracting parties must undertake that state-trading enterprises which they establish comply with this principle. However, paragraph 2 of this Article states that the principle enunciated in paragraph 1 shall not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods for sale. Here again, state enterprises which import products for governmental consumption are exempted from non-discrimination principles. Such enterprises are obligated only to give 'fair and equitable treatment' to the trade of the other contracting parties.

Contracting parties came to think that exceptions of government procurement from WTO disciplines would be detrimental to the free trade principle and needed to be revised. This issue was taken up both in the GATT and the OECD. In the Tokyo Round Negotiation, negotiating parties agreed to enter into an agreement on government procurement which modified the GATT 1947.

2.2 The Tokyo Round Agreement

The Tokyo Round Agreement (1979) on government procurement contained a Preamble, nine Articles, two commentaries, and four Appendices of which the major

features are discussed here. The Preamble provided for national treatment and non-discrimination in government procurement, transparency in laws and regulations related to government procurement, and special treatment for developing countries. Article 1 provided that the Agreement would apply to laws and regulations regarding government procurement if the amount being spent by governments involved was 150,000 Special Drawing Rights (SDR) or above and that the central government concerned should request the compliance of those terms by local governments to which the Agreement did not directly apply.

The Tokyo Round Agreement provided that the principles of national treatment and non-discrimination be applied, that is, parties were required to apply national treatment and non-discrimination principles in government procurement (Article 2). It also provided for special measures for developing countries to the effect that parties had to enforce domestic procurement regulations so as to promote imports from developing countries and exempt developing countries from the national treatment principle on the condition that periodical review would be made. Developed countries would give technical assistance to developing countries with regard to government procurement if there was a need for such assistance and they would disseminate information on government procurement to developing countries.

The Tokyo Round Agreement provided three types of procurement procedures, namely, open bid, selective bid as the principal procedure for government procurement (Article 5), and single tendering (an individually negotiated contract). Single tendering was allowed only as an exception. It could be used only when (a) there was no bid or the bid was rigged, (b) the object of procurement could be obtained only from a specific source such as artistic objects, (c) an open bid or selective bid was impossible due to emergency needs, (d) a change of supplier was not possible because of the existence of the prior used facilities or products, or (e) when a product which was the result of a contract for research and development was purchased. There was provision for exceptions based on, inter alia, national security, public order, and prevention of disease (Article 8).

In 1988, the Tokyo Round Agreement was modified by the Protocol to Amend the Agreement on Government. The major amendments included: (a) The Agreement would cover all kinds of procurement including purchase, lease, rental, and hire-purchase; (b) The threshold was lowered to 130,000 SDR; (c) Locally established suppliers would enjoy the benefit of the national treatment and non-discrimination principles; and (d) The procurement entity would not request or receive advice from a directly interested enterprise with regard to technical standards.

The application of the Tokyo Round Agreement was generally limited to procurement of goods by central government entities and procurement by local governments and entities related to governments. Construction, design, and consulting were excluded from its application. Also preferential treatment of developing countries was not sufficient. In light of the above, it was felt necessary to negotiate a new agreement. This negotiation took place in parallel with the negotiation for the Uruguay Round agreements. Although there were many difficulties, the final Agreement was reached on 15 December 1993.

2.3 The WTO Government Procurement Agreement

The Agreement on Government Procurement at the WTO, agreed on 15 December 1993 and entering into force on 7 April 2014, consisted of twenty-three Articles and four Appendices and took effect on 1 January 1996. At present, thirty-nine members have joined the Agreement (eleven members and the twenty-eight EU Member States). This was a plurilateral trade agreement (Annex 4 of the WTO Agreement) binding only on the parties which opted to join it. The Agreement largely succeeded the principles in the Tokyo Round Agreement such as the principles of national treatment and non-discrimination. In addition, however, there were some new features in the Agreement. These are, inter alia, (a) The coverage is wider and includes not only goods but also services; (b) Not only central governments but also local governments are subject to the international disciplines; and (c) Parties are obligated to establish domestic challenge procedures to resolve disputes that arise under this Agreement. However, through bilateral agreements, some parties excluded some other specified parties from the application of the Agreement in certain areas.

3. The 2012 Government Procurement Agreement

3.1 An overview of the 2012 Agreement

Negotiations were initiated in 1999 to revise the Government Procurement Agreement so that it would be more attractive to other WTO members. Negotiations were a slow process but momentum was picked up in 2010, and in December 2011, negotiations were concluded. On 30 March 2012, a revised version of the Agreement was formally approved (hereinafter 'the Agreement'). The new commitments under the revised Agreement are subject to ratification by members with the acceptance of two-thirds of the fifteen parties needed to bring it into force.[5] The total number of parties (states and regions) to this revised Agreement is currently forty-three.[6]

The Agreement has twenty-one Articles and Annexes.[7] It contains, inter alia, such items as security and general exceptions, developing countries, information on the procurement system, conditions for participation, qualification of suppliers, technical specifications and tender documentation, limited tendering, electronic auctions, treatment of tenders and awarding of contract, transparency of procurement information, and domestic review procedures. Under the revised Agreement, the threshold value of procurement at which the Agreement applies is lowered as indicated in the Appendices

[5] Lichtenstein ratified the Agreement on 30 March 2012. It is the first WTO member which ratified the Agreement (<http://www.wto.org/english/news_e/news13=e/gpro_02may 13_e.htm>).

[6] Namely, Armenia, Canada, the EU (with regard to its twenty-eight Member States), Hong Kong, China, Iceland, Israel, Japan, Korea, Liechtenstein, the Netherlands with respect to Aruba, Norway, Singapore, Switzerland, Chinese Taipei, and the United States. Observers are Albania, Argentina, Australia, Bahrain, Cameroon, Chile, China, Columbia, Croatia, Georgia, India, Jordan, Kyrgyz Republic, Moldova, Mongolia, New Zealand, Oman, Panama, Saudi Arabia, Sri Lanka, Turkey, and Ukraine.

On 27 June 2013, the WTO Committee on Government Procurement approved a modification to the EU's schedules to the GPA which brought Croatia (which had recently entered the EU) under the Agreement as of 1 July 2013 (<http://www.wto.org/english/new_e/news13_e/gpro_27jun13_e.htm>).

[7] GPA/W/313, 16 December 2010.

to the Agreement. For example, Japan made a concession that the threshold at which the Agreement applies is lowered from 130,000 SDR to 100,000 SDR. More central and sub-central government entities are included in the covered entities to which the Agreement applies as shown in the Appendices to the Agreement. Also developing country members are given the power to use a price preference programme whereby a developing country member gives domestic suppliers more favourable conditions for tendering and other terms than those given to foreign suppliers. Since the use of electronic devices has become popular, the Agreement incorporates provisions for bids by electronic devices.

We go on to discuss the major features of the Agreement.

3.2 Electronic auction

The Agreement contains provisions for electronic auction in addition to traditional auctioning. Electronic auction is defined as 'an interactive process that involves the use of electronic means for the presentation by suppliers of either new prices, or new values for quantifiable non-price elements of the tender related to the evaluation criteria, or both, resulting in a ranking or re-ranking of tenders.' (Article I(f)). Provisions of the Agreement apply whether a procurement is made by an electronic or non-electronic means (Article II:1).

3.3 Scope and coverage

Article II:2(a) states that the Agreement applies to any governmental procurement of goods, services, or any combination as specified in each party's annexes to Appendix I and not procured with a view to commercial sale or resale or for use in the production or supply of goods or services for commercial sale or resale. It applies to any procurement for which the value equals or exceeds the relevant threshold specified in a party's annexes to Appendix I, at the time of publication of a notice of tendering (Article II:2 (c)). Each party must specify the following information in its annexes to Appendix I: (a) in Annex 1, the central government entities whose procurement is covered by this Agreement; (b) in Annex 2, the sub-central government entities whose procurement is covered by this Agreement; (c) in Annex 3, all other entities whose procurement is covered by this Agreement; (d) in Annex 4, the goods covered by the Agreement; (e) in Annex 5, the services, other than construction services, covered by this Agreement; (f) in Annex 6, the construction services covered by this Agreement; and (g) in Annex 7, any General Notes.

Article II:6 provides that a procuring entity shall not divide a procurement into separate procurements nor select or use a particular valuation method for estimating the value of a procurement with the intention of totally or partially excluding it from the application of the Agreement. This is to prevent members from dividing a single procurement into a number of procurements or otherwise manipulating the valuation of the procurement so that each is below the threshold and therefore not subject to the disciplines of the Agreement.

3.4 Security and general exceptions

Article III:1 provides that members can take any action to protect their essential national security interests relating to the procurement of war materials. Also paragraph 2 of this Article allows members to take measures (a) necessary to protect public morals, order, or safety; (b) necessary to protect human, animal or plant life, or health; (c) necessary to protect intellectual property; or (d) relating to goods or services of persons with disabilities, philanthropic institutions, or prison labour.

3.5 General principles—non-discrimination

The general principle in procurement is non-discrimination and Article IV:1 and :2 prohibits discrimination between domestic and foreign suppliers supplying like products or services, between locally established suppliers with foreign affiliation or ownership and suppliers without such affiliation and between local suppliers which supply goods or services of any other members.

3.6 Developing countries

One of the purposes of the revision of the Agreement in 2011 was to induce more developing country members to join the WTO regime on government procurement and thus, preferential treatment is accorded to developing countries. Provisions in Article V are devoted to the treatment of developing countries. Article V:1 states that the parties shall give special consideration to the development, financial and trade needs, and circumstances of developing countries and least developed countries and recognize that these may differ from country to country.

In light of this, developing country members are allowed to adopt: (a) a price preference programme (giving preferential prices to domestic supplies as necessary), (b) an offset (measures that encourage local development such as use of domestic content and similar actions), (c) the phased-in addition of specific entities or sectors, and (d) a threshold that is higher than its permanent threshold during the transition period (Article 5:3(a)–(d)). The transition period is stipulated as five years for a least developed country and three years for other developing countries after the accession to the Agreement (Article V:4(a) and (b)) and this transition period can be extended if the Committee of Government Procurement grants it.

3.7 Tendering

The Agreement provides for three types of tendering, namely, open tendering, selective tendering, and limited tendering. Open tendering means a procurement method whereby all interested suppliers may submit a tender. Selective tendering means a procurement method whereby only qualified suppliers are invited by the procuring entity to submit a tender. It is clear that open tendering and selective tendering are the preferred methods of tendering and limited tendering can be used only when, as

specified in Article XIII, there are reasons that open tendering and selective tendering cannot be used. Contents of Article XIII are explained below.

In principle, procuring entities should impose only those conditions that are essential to ensure that a supplier has the legal and financial capacities, and the commercial and technical abilities, to undertake the relevant procurement (Article VIII:1). However, where there is supporting evidence, procuring entities can exclude a supplier on grounds such as bankruptcy, false declarations, significant or persistent deficiencies in performance of any substantive requirement or obligation under a prior contract or contracts, final judgments in respect of serious crimes or other serious offences, professional misconduct or acts or omission that adversely reflect on the commercial integrity of the supplier, or failure to pay taxes (Article VIII:4(a)–(f)).

Details of limited tendering are provided for in Article XIII. According to this Article, limited tendering can be used only under the following circumstances.

(a) Where: (i) no tenders were submitted or no suppliers requested participation; (ii) no tenders that conform to the essential requirements of the tender documentation were submitted; (iii) no suppliers satisfied the conditions for participation; or (iv) the tenders submitted have been collusive;
(b) Where the goods or services can be supplied only by a particular supplier and no reasonable alternative or substitute goods or services exists for any of the following reasons: (i) the requirement is for a work of art; (ii) the protection of patents, copyrights, or other exclusive rights; or (iii) due to an absence of competition for technical reasons;
(c) For additional deliveries by the original supplier of goods or services that were not included in the initial procurement where a change of supplier for such additional goods or services (i) cannot be made for economic or technical reasons such as requirements of interchangeability or interoperability with existing equipment, software, services, or installations procured under the initial procurement; and (ii) would cause significant inconvenience or substantial duplication of costs for the procuring entity;
(d) Insofar as is strictly necessary where, for reasons of extreme urgency brought about by events unforeseeable by the procuring entity, the goods or services could not be obtained in time using open tendering or selective tendering;
(e) For goods purchased on a commodity market;
(f) Where a procuring entity procures a prototype or a first good or service that is developed at its request in the course of, and for, a particular contract for research, experiment, study, or original development. Original development of a first good or service may include limited production or supply in order to incorporate the results of field testing and to demonstrate that the good or service is suitable for production or supply in quantity to acceptable quality standards, but does not include quantity production or supply to establish commercial viability or to recover research and development costs;
(g) For purchases made under exceptionally advantageous conditions that only arise in the very short term in the case of unusual disposals such as those arising

from liquidation, receivership, or bankruptcy, but not for routine purchases from regular suppliers;

(h) Where a contract is awarded to a winner of a design contest provided that: (i) the contest has been organized in a manner that is consistent with the principles of the Agreement, in particular relating to the publication of a notice of intended procurement; and (ii) the participants are judged by an independent jury with a view to a design contract being awarded to a winner.

3.8 Technical specifications

Article X of the Agreement requires that (a) the technical specifications for the goods or services be set out in terms of performance and functional requirements rather than design or descriptive characteristics and (b) they should be based on international standards where such exist. It is to be noted that, unlike Article 2:4 of the Technical Barriers to Trade Agreement (TBT), it does not provide that specifications be based on international standards where 'the completion of such is imminent'. A procuring entity shall not seek or accept, in a manner that would have the effect of precluding competition, advice that may be used in the preparation or adoption of any technical specification for a specific procurement from a person that may have a commercial interest in the procurement (Article X:5).

Article XVI:1 requires that a procuring entity promptly inform participating suppliers of the entity's contract award decisions and, on the request of a supplier, shall do so in writing. Also a procuring entity shall, on request, provide an unsuccessful supplier with an explanation of the reasons why the entity did not select its tender and the relative advantages of the successful supplier's tender.

3.9 Domestic review procedure

Each party is required to provide a challenge procedure in a transparent and non-discriminatory manner through which a breach by a domestic procuring entity of the Agreement can be challenged by a supplier and, where a party fails to implement the Agreement under its domestic laws and regulations, such failure can be challenged (Article XVIII:1). For this purpose, each party must establish or designate at least one impartial administrative or judicial authority that is independent of its procuring entities to receive and review a challenge by a supplier arising in the context of a covered procurement (Article XVIII:4).

3.10 Consultations and dispute settlement

If there arises any dispute between the parties regarding the Agreement, each party must engage in consultation to resolve this dispute and, if consultation fails, a party has recourse to the dispute settlement procedure under the Dispute Settlement Understanding (DSU) (Article XX).

3.11 Negotiations under GATS Article XIII

GATS Article XIII states that government procurement of services is not subject to the disciplines of the most favoured nation (MFN) requirement of GATS Article II, to specific commitments on market access of GATT Article XVI nor to national treatment of GATS Article XVII. Therefore, WTO members are not subject to any obligations on market access or non-discrimination in government procurement of services under the GATS. GATS Article XIII states also that there shall be a negotiation on government procurement in services within two years from the date of entry into force of the GATS with a view to establishing access and non-discrimination in the fields of services. A Working Party was established to discuss this issue. There is no indication of the deadline for this negotiation. However, the guidelines adopted in March 2001 stated that members shall aim to complete the negotiations prior to the conclusion of the Doha negotiations. The Ministerial Declaration issued by the Hong Kong Ministerial Conference in December 2005 included a provision stating: 'Members should engage in more focused discussions and in this context put greater emphasis on proposals by Members, in accordance with Article XIII of the GATS'. However, no result has been achieved to date.

4. Domestic Implementation

4.1 Article XXIII of the Agreement

As stated in section 3.9 of this chapter, Article XXIII of the Agreement requires each party to establish a procedure through which a supplier can challenge decisions of a procuring entity for breach of the Agreement at a judicial or administrative body. This Article requires domestic implementation of the Agreement in the jurisdiction of each party. In accordance with this provision, parties to the Agreement reported to the Government Procurement Committee of the WTO as to how provisions of the Agreement are implemented. By way of example, this section provides a brief look at the domestic implementation of the three jurisdictions, namely, the EU, the United States, and Japan.

4.2 The European Union

In the EU, general public procurement rules are provisions in the EU Treaty which have been completed by Community Directives.[8] The basic provisions in the EU Treaty on government procurement are Articles 6 to 36 which provide for non-discrimination on grounds of nationality principles and the ban on quantitative restrictions on imports and all measures having equivalent effects. Also Article 52 *et seq.* provide the right to establishment in the territory of another Member State and Article 59 *et seq.*

[8] Notification of National Implementing Legislation, Communication from the European Community, World Trade Organization, GPA/20, 28 January 1998; Review of National Implementing Legislation, European Community, World Trade Organization, GPA32, 12 January 2000.

the freedom to provide services. There is a group of Directives which lay down rules of government procurement.

The Agreement was transplanted into EU law by Council Decisions No. 94/800/EC of 22 December 1994 which required that EU Member States incorporate its content into their national laws and regulations. Therefore, with respect to procurement above the threshold value, EU law and domestic laws of the Member States reflect principles of the Agreement. However, for contracts below the thresholds, national rules are not bound by EU Directives and national laws are not necessarily uniform. Although each Member State has its own public procurement rules, these must comply with the general principles of the EU Treaty providing for non-discrimination in respect of goods and services.

The Directives issued for implementing the Agreement fall into two categories: (a) those governing the traditional areas of public procurement (public Directives or traditional sectors Directives) and (b) those dealing with utilities such as water, energy, transport, and telecommunications. Each group is completed by a remedies Directive. The principles of those Directives include a ban on discrimination, open access to all EU suppliers, transparency of award procedures, a precise indication of which of the permissible award procedures has been chosen, compliance with technical requirements, and transparency of the procedures for selecting contractors and awarding contracts. The EC Report to the Committee explains the details of how each Member State has implemented those Directives.

4.3 The United States

In the United States, there are a number of laws and regulations relevant to domestic implementation of the Agreement.[9] The major laws and regulations include (a) Uruguay Round Agreements Act, (b) Trade Agreements Act of 1979, (c) Federal Acquisition Regulation, (d) Armed Services Procurement Act, (e) Federal Property and Administrative Services Act, and (f) Office of Federal Procurement Policy Act.

The Uruguay Round Agreements Act[10] approves the trade agreements which are the result of the Uruguay Round and provides for implementation and entry into force of those agreements. This Act amends the Trade Agreements Act of 1979 and authorizes the President of the United States to implement the content of the Agreement. The Federal Acquisition Regulation (the FAR) establishes policies and procedures for acquisition by all United States agencies.

In accordance with the Uruguay Round Agreements Act, the Agreement took effect in the United States on 1 January 1996. All federal government entities, in a narrow sense of the words, and those listed in Annex 3 are subject to the Trade Agreements Act of 1979 and therefore to the Agreement. Such entities include the St. Lawrence Seaway

[9] Notification of National Implementing Legislation, Communication from the United States, GPA/23, 15 July 1998; Review of National Implementing Legislation, United States, GPA/50, 15 June 2001.

[10] For details of this Act, see Uruguay Round Trade Agreements, Texts of Agreements, Implementing Bill, Statement of Administrative Action, and Required Supporting Statements, 103d Congress, 2d Session, House Document 103–316, Vols. I and II (1994).

Development Corporation, the Tennessee Valley Authority, and the Bonneville Power Administration. Although federal laws and regulations do not govern procurement by state governments, state governments must comply with certain federal requirements when these receive grants from the federal government and carry out projects by such grants.

The Trade Agreements Act of 1979, as amended by the Uruguay Round Agreements Act, authorizes the President of the United States to waive the application of any discriminatory measures, and the President ordered federal agencies that are covered by the Agreement to comply with obligations to the Agreement. Although the Federal Buy American Act of 1933[11] requires federal agencies to purchase US products and make contracts with construction agencies which use US products in principle, the restrictions of the Buy American Act do not apply to procurements that are subject to the Agreement. To that extent, therefore, the Federal Buy American Act has been superseded by the Agreement. This waiver does not cover Buy American and Buy State laws and regulations of states.

4.4 Japan

In Japan,[12] the basic law governing government procurement is the Account Law.[13] Under this law, a number of cabinet orders are issued which include, inter alia, the Cabinet Order Concerning the Budget, Auditing and Accounting, the Special Order Concerning the Budget, Auditing and Accounting, and the Regulations on the Management of Contract Administration.

With respect to local government, the Local Autonomy Law,[14] the ordinance for Enforcement of the Local Autonomy Law, and the Cabinet Order Stipulating Special Procedures for Government are the major laws and regulations. It can be said that these laws and regulations are generally in conformity with provisions of the Agreement.

In Japan, one of the big issues in government procurement has been that of bid-rigging. In many cases, bid-rigging practices are rooted in a close relationship between the procurement agencies and bidders. In a selective bid, the procurement agencies can wield a powerful control over potential bidders and this situation may create exclusive groups which would be selected as qualified bidders. It is clear that these practices adversely affect the openness of the procurement market in Japan. However, this is more a problem of competition policy and law than the international procurement agreement.[15]

[11] Buy American Act of 1933, 41 U.S.C. 10 (a)–(d) (1996).

[12] Notification of National Legislation of Japan, Communication from Japan, World Trade Organization, GPA/37, 20 June 2000; GPA/67, 15 April 2002; Jean Heilman Grier, 'U.S.–Japan Government Procurement Agreements' (Fall 1995) *Wisconsin International Law Journal* 14(1), 1–68 discusses some features of Japanese procurement practices. Although this article appeared before the inauguration of the WTO, some features described there still remain true.

[13] Law No. 35, 31 March 1947.

[14] Law No. 67, 1947.

[15] On this issue, see generally H. Iyori and A. Uesugi, *The Antimonopoly Laws and Policies of Japan* (New York: Federal Legal Publications, Inc., 1994) 86–92. The information contained in this volume is somewhat outdated. However, its description of the nature of problems is still valid today.

5. Dispute Settlement in Relation to the Government Procurement Agreement

5.1 In general

Government procurement is a large market in terms of volume and value of transactions and there are many disputes with regard to openness of the procurement market. However, only a relatively small number of disputes have been raised via the WTO dispute settlement procedures under the GPA and dispute settlement bodies established by the parties.[16] The small number of disputes that are reported may be due to the fact that the Agreement is one of the plurilateral agreements, thus whether to join it or not is optional and the number of parties which have done so is relatively small. It may also be that disputes handled by national courts and other dispute settlement bodies are not widely publicized.

In any event, there are two kinds of dispute with regard to the Agreement, namely, those raised before the WTO Dispute Settlement Body (DSB) and those handled by challenge procedures in the national jurisdictions of parties established in accordance with Article XX of the Agreement.

5.2 GATT/WTO disputes

So far there are two adopted GATT/WTO Panel reports which interpreted and applied the Government Procurement Agreement. One is the *Trondheim* case in which the GATT Panel interpreted and applied provisions of the Tokyo Round Government Procurement Agreement and the other is the *Korean Inchon Airport* case in which the WTO Panel interpreted and applied provisions of the Agreement.

5.1.1 The Trondheim *case*

This case involved the award of a contract related to electronic toll collection equipment for a toll system around the city of Trondheim to a Norwegian company, Micro Design, by the Norwegian Public Roads Administration.[17] The award was made by way of single tendering. The United States took Norway to the GATT dispute settlement procedures and argued that Norway did not meet the requirement of Article V:15(e) of

[16] Under the GPA, three claims were brought to the WTO dispute settlement procedures. They are: *Korea—Measures Affecting Government Procurement* (Complainant: United States), consultation requested on 16 February 1999 (to be discussed in section 5.2.2), *United States—Measures Affecting Government Procurement* (Complainant: Japan), consultation requested on 18 July 1977, settled or withdrawn, and *Japan—Procurement of a Navigation Satellite* (Complainant: European Communities), consultation requested on 26 March 1997, settled or withdrawn.

[17] *Norway—Procurement of Toll Collection Equipment for the City of Trondheim*, Report of the Panel adopted by the Committee on Government Procurement on 13 May 1992 (GPR.DS2/R), B.I.S.D. 40S/319 (referred to as '*The Trondheim Report*'). For a comment on this case, see Petros Mavroidis, 'Government Procurement Agreement—The Trondheim Case: the Remedies Issue' (1993) *Swiss Review of International Economic Relations* 48, 77 *et seq*.

the Tokyo Round Agreement.[18] Article V:15 of the Tokyo Round Agreement provided that a procurement entity could use single tendering instead of open or selective tendering if there were certain conditions and, as one of such conditions, Article 15 (e) stated that a procurement entity could use single tendering 'when an entity purchases prototypes or a first product which are developed at its request in the course of, and for, a particular contract for research, experiment, study or original development.' The United States also argued that, in conducting the procurement, Norway had failed to respect its obligations under Article II:1 to accord to the products and suppliers of other parties treatment no less favourable than that accorded to domestic products and suppliers.

The Panel noted, as a general proposition, that Article V:15 is a provision for exceptions and needed to be interpreted narrowly, and that it was incumbent on the respondent, Norway, to prove that its invocation was justified.[19] The Panel stated that the question before it was whether the Norwegian Public Roads Administration had procured prototypes which had been developed at its request in the course of, and for, a particular contract for research or original development. According to the Panel, the crucial question was what the procuring entity was procuring (that is, the output that it was procuring) and not the nature of the work that would have to be undertaken by the supplier to supply the goods and/or services being procured. The Panel held that the phrase 'contract for research . . . or original development' had to be understood as referring to a contract for the purpose of the procurement by the procuring entity of the results of research and/or original development, that is, knowledge.[20]

The Panel went on to state that, in order to be covered by Article V:15(e), Norway had to demonstrate that (1) the Norwegian Public Roads Administration had as its principal purpose in concluding the contract the procurement of the results of research and/or original development from Micro Design, and (2) that the principal purpose of the equipment procured from Micro Design under the contract was to provide a means of further developing the knowledge generated through that research and/or original development. In the view of the Panel, Norway did not fulfil the burden of proof on this issue. All of the evidence provided by Norway only indicated that the principal purpose of the contract of Norwegian Public Roads Administration with Micro Design had been the procurement of operational toll collection equipment for a functioning toll rig system.

The Panel further noted that Norway had not claimed that the Public Roads Administration had plans to procure further toll ring systems on the basis of the model developed at Trondheim and found that Norway had not shown that the principal purpose of the Norwegian Public Roads Administration had been the procurement of the results of research and/or development rather than operational toll collection equipment as part of a functioning toll ring system.[21]

[18] In this report, the Panel refers to Art. V:16 (e). However, Art. V:16(e) seems to be irrelevant to the issue here, and it seems likely that the Article in question must have been Art. V:15(e). Therefore, in this chapter, Art. V:15(e) is referred to.

[19] *The Trondheim Report*, para. 4.5.

[20] Ibid. para. 4.8.

[21] Ibid. paras. 4.10–4.11.

For these reasons, the Panel found that the single tendering of the contract by the Norwegian Public Roads Administration did not meet the requirements of Article V:16(e).

Then the Panel addressed the issue of recommendation that was raised by the United States. The United States argued that the Panel should recommend that Norway bring its procurement procedures into conformity with the Tokyo Round Agreement and also that Norway negotiate with the United States a mutually satisfactory solution taking into account the lost opportunities for US companies. However, the Panel declined from making such a recommendation for the reason that it was not the past practice of Panels to recommend anything more than a request of conformity with the agreement in question and that there was no provision in the Tokyo Round Agreement to clarify that wider recommendations were within the power of Panels.

5.1.2 The Korean Inchon Airport *case*

This is a case concerning the construction of Inchon International Airport in South Korea.[22] Originally the Ministry of Transportation and the New Airport Development Group which was under the jurisdiction of the Ministry were responsible for the construction. By the Seoul Airport Act, the authority to construct the airport was given to the Korean Airport Authority and subsequently to the Inchon International Airport Corporation. The United States petitioned the WTO DSB claiming that all of those entities were covered by the 1995 Government Procurement Agreement and it was wrong for the Korean government to impose requirements on bid deadlines, qualification, and domestic partnership. It also alleged that Korea had failed to establish a proper dispute settlement body in accordance with the Agreement.

The Panel focused on the issue of whether the Korean Airport Authority was included in the entities in Korea's GPA Appendix. Korea argued that it was not covered by the Agreement. The Panel stated first that the schedules in GPA constituted part of the Agreement and were subject to the rules of interpretation as incorporated in Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT).

The Panel noted that Note 1 to Annex 1 of the Korean concession stated that the central government entities included their subordinate linear organizations, special local administrative organs, and attached organs as prescribed in the Government Organization Act of the Republic of Korea. After examining the wording of Note 1, the Panel concluded that the Korean Airport Authority could not be included in the concession of Korea and that it was not legally unified with the government and was established by law as an independent entity. It also enacted its own by-laws and had its own management and employees who were not government employees. On the basis of this sort of evidence, the Panel concluded that the Inchon International Airport Project was not covered by the Agreement.[23]

[22] *Korea—Measures Affecting Government Procurement*, Panel report, WT/DS163/R, 19 June, 2000 (hereinafter referred to as '*The Korean Report*').

[23] *The Korean Report*, para. 7.36.

The United States also raised a non-violation complaint alleging that its interest was nullified and impaired. The Panel pointed out that this case was different from traditional non-violation cases in that Korea had made no concession with respect to the Korean Airport Authority and the United States could not have suffered nullification and impairment of a concession that had not been given. However, the Panel pointed out that a non-violation was related to *pacta sunt servanda* and this applied to negotiations for concessions as well as concessions that had been already given. The Panel also stated that a non-violation could be related to an infringement of reasonable expectation with regard to trade negotiations. On this premise, the Panel examined whether there was a nullification and impairment suffered by the United States.[24] The Panel held that the Seoul Airport Act which authorized the Korean Airport Authority to carry out the project was enacted in December 1991 and the United States bore the burden of proving that it had not known the legislation or the meaning of it at the time of trade negotiation. Korea claimed that the United States did know this legislation at the time of negotiation and other WTO members took derogations on airport matters in their schedules because of Korea's legislation. For this reason, the Panel held that the United States did not bear the burden of proof and rejected the US claim for nullification and impairment.[25]

In disposing of the non-violation issue in this case, the Panel stated that nullification and impairment could refer not only to that of benefit that had been conferred by a concession but also to expectation of concessions in trade agreement negotiations. This aspect had not received much attention in earlier Panel and Appellate Body reports.

5.2.3 The State of Massachusetts *case*

Strictly speaking, this case was not raised in a domestic dispute settlement procedure established under the GPA as explained earlier. This case arose out of legislation in the State of Massachusetts in the United States entitled 'An Act Regulating State Contracts with Companies Doing Business with or in Burma (Myammar)'.[26] A trade association in the United States brought a suit against the State of Massachusetts and argued that this legislation was a violation of the Constitution of the United States because it overstepped the boundary beyond which states' powers did not reach. Therefore, this case was brought as a constitutional case in the United States. However, the substance of this dispute was exactly the same as that of a WTO case brought to the WTO dispute settlement procedure by the EC and Japan. The Panel established by the WTO stayed its proceeding in consideration of the fact that the issue may be resolved domestically and, in this sense, this domestic case is relevant to the WTO.

This law in the State of Massachusetts prohibited state entities from purchasing goods and services from any persons who were doing business in or with Burma. The purpose of this law was to impose economic sanctions on Burma for infringement of human rights and political oppressions. In 1998, the EC and Japan brought a petition to the WTO DSB against the United States on the ground that this law infringed certain

[24] Ibid. para. 7.99. [25] Ibid. para. 7.116.

[26] Mass. Acts 239, ch. 130 (codified at Mass. Gen. Law, Para 7:22 GM, 40 1/2 (1997)).

provisions of the Agreement and a Panel was established.[27] The National Foreign Trade Council, a trade association in the United States, brought a suit against the State of Massachusetts in US courts on the ground that the measures of the State of Massachusetts were contrary to the Constitution of the United States. The case was argued and decided by the US District Court[28] and Court of Appeals[29] and then petitioned to the Supreme Court of the United States.[30] The EC and Japan took into consideration the fact that a domestic proceeding was pending in the United States with regard to this legislation and suspended the Panel proceeding.[31] The Panel was disbanded when twelve months had passed after the suspension.

The Supreme Court of the United States held that the law in question was contrary to the Constitution of the United States. A brief summary of this decision follows.

The Massachusetts Law in question here passed the Congress of the State of Massachusetts in 1996 and subsequently, the US Congress imposed sanctions on Burma which were limited to certain areas. The Foreign Trade Council, a private association, brought a suit in the US courts seeking an injunction restraining state officials from enforcing this law for the reason of unconstitutionality. The Council argued that the law infringed the federal government's power to conduct foreign affairs. Both the District Court and the Court of Appeals upheld the injunction. The State of Massachusetts appealed to the Supreme Court of the United States.

The Supreme Court pointed out that the US Congress authorized the President of the United States to impose sanctions and withdraw them when a situation improves, that is, Congress conferred on the President discretion and flexibility in imposing and withdrawing such sanctions. However, the Massachusetts Law in question imposed immediate and perpetual sanctions and there was no termination clause. In this way, the State Law erected an obstacle to the smooth operation of this presidential power. State law must yield to a federal power if the US Congress intends to occupy the area.

The State Law prohibited some contracts even when the federal laws permitted them and, although federal prohibitions applied only to US citizens, the State Law applied to every person doing business in or with Burma. The Supreme Court stated that, in this respect, there was a conflict between the State Law and federal regulations. Finally the Supreme Court held that the State Law infringed the authority of the President of the United States to conduct diplomacy with other nations and was unconstitutional for this reason.

This case is a domestic one in the United States. However, as stated earlier, the subject matter dealt with in the case was also that of the WTO Agreement. It is significant that the Supreme Court mentioned the fact that some nations had brought

[27] *United States—Measure Affecting Government Procurement—Constitution of the Panel Established at the Request of the European Communities and Japan—Communication from the DSB Chairman*, WT/DS88/4; WT/DS95/4.

[28] *National Foreign Trade Council v Baker*, 26 F. Supp. 2d (D. Mass. 1998).

[29] *National Trade Council v Natsios*, 181 F. 3d 38 (C.A. 1 1999).

[30] *Crosby v National Foreign Trade Council*, 520 U.S. 372 (2000).

[31] *US—Measures Affecting Government Procurement—Communication from the Chairman of the Panel*, WT/DS/88/5; WT/DS95/5.

claims against the United States in the WTO and relied on this fact to claim that the matter belonged to the diplomatic power of the President.

5.2.4 The Japan Railway *case—a dispute settlement at challenge procedures*

As stated earlier, Article XX of the Agreement requires that parties establish domestic challenge procedures with which foreign enterprises can lodge complaints against procurement entities on account of violation of the Agreement. Parties must establish such procedures in their domestic jurisdictions. In the following, a Japanese case will be discussed as an example of such dispute settlement at challenge procedures.

The Japanese government established a dispute settlement body called The Office for Government Procurement Challenge System (CHANS) within the Secretariat Office of the Cabinet. CHANS is authorized to receive complaints from foreign enterprises with regard to the implementation of Japanese procurement entities under the Agreement and to issue recommendations to the entities in question. So far there have been eleven cases before CHANS and one case before the dispute settlement body established by the Osaka Fu.[32]

One of these cases is the *Japan Railway* ('*JR*') case.[33] JR, originally part of the government running railways throughout the country and later privatized to a joint-stock company, is designated as one of the entities covered by the Agreement. The issue involved was the procurement by JR of an electronic system used to operate automatic ticket gates at train stations. JR held an open bid and Sony, a Japanese company, won the contract. Motorola, a US company which was unsuccessful in the bid, brought a claim against JR before CHANS. The complaint was based on five grounds, namely, (a) non-adoption of international standards, (b) the use of specifications which cause unnecessary obstacles to international trade, (c) an inappropriate use of advice, (d) an unreasonable period for offering a trial product and the final product, and (e) an improper opening of bids. A rule established by CHANS states that a complaint should be made within ten days after specifications were handed down. In this case, however, Motorola submitted a complaint after this period had expired. CHANS, therefore, held that the complaint by Motorola must be rejected for the reason that it was submitted in an untimely manner. However, CHANS went on to express its view of the claims in any case. Only items (a) and (b) will be discussed below.

At the time of the dispute, a draft of an international standard concerning the electronic devices involved in this case was examined by the ISO (the standards setting organization). This standard is called ISO/IEC144431 TypeB ('TypeB') and, on this, the 'Final Draft International Standard' (FDIS) was about to be adopted. Motorola argued that the Agreement requires that domestic standards be based on international standards and the adoption of an international standard was imminent. It argued that, when domestic standards are adopted, they should be based on FDIS.

[32] Some of these cases are briefly summarized in Attachment 6 of the document cited at n. 11.

[33] *Report of CHANS* on 3 October 2000. This report in Japanese is available at <http://www5.cao.go.jp/access/japan/chans_main_j.html>. For the current number of dispute before CHANS, see the website of CHANS (Public Release of Status of Receipt and Review of Complainants, <http://www5.cao.go.jp/access/english/chans_main_e.html>).

CHANS held that Article 6:2 of the Agreement requires that domestic standards be based on international standards 'when they exist' and that it was clear that FDIS had not been adopted when the bid was made. On this ground, CHANS rejected Motorola's claim.

Motorola claimed that TypeB was a de facto standard and JR should have based its procurement on this. However, CHANS held that TypeB did not reach the level of de facto standard.

JR announced that it would use the IC card system that it had developed jointly with Sony, the successful bidder. Motorola argued that this amounted to an inappropriate use of advice given by the successful bidder. On this issue, CHANS held that the mere fact that JR had jointly developed the IC card system with Sony did not mean that JR had inappropriately relied on advice given by Sony in the procurement of the system in question in this case.

As mentioned earlier, there is difference between the Agreement and the TBT Agreement in the treatment of international standards whose adoption is imminent. Article 2.4 of the TBT Agreement provides that an international standard whose adoption is imminent should be relied on by members when adopting domestic standards. However, the word 'imminent' is lacking in the Agreement. CHANS, therefore, took a literal interpretation and decided that the Agreement did not cover a draft international agreement although its adoption may be imminent. This seems clear from textual analysis of both Agreements. However, it is significant that this interpretation was recognized by CHANS.

On the other hand, the remark of CHANS on de facto standards is misplaced. A glance through the texts of the Agreement leaves one in no doubt that de facto standards are not covered by the Agreement. CHANS stated that Type B was not a de facto standard. This may have been simply a response to Motorola's claim that Type B was a de facto standard and should have been relied upon. However, this statement is misleading because, by *a contrario* interpretation, a de facto standard could be regarded as being covered by the Agreement if it is established as a de facto standard. This was probably not CHANS's intention. It would seem prudent, however, for a dispute settlement body to refrain from making statements that may be misleading.

19

Developing Countries

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1. Bifurcating the GATT Obligations

1.1 The early years

The original GATT membership was a rather homogeneous group of twenty-three countries. Following the advent of the GATT a number of countries gained their independence and eventually joined the GATT. A large number of them were rather poor, developing countries. They were encouraged to join the GATT in light of the unambiguous desire of the GATT contracting parties to increase participation in the Agreement.

Developing countries were joining an agreement which was not designed as a two-tier system: the GATT provisions, with very few exceptions, were one fit for all irrespective of the level of development of participants. From the early days of their participation, developing countries aimed at changing this picture, first by introducing the possibility of preferential tariffs for developing countries' products, and eventually by encouraging the WTO, the successor of the GATT, to take its place in the global inter-institutional dialogue on development. This is how the story unfolds.[1]

Developing countries initially felt that they could not compete for export markets on an equal basis with developed countries. In their view, the most favoured nation (MFN)

[1] There are dozens of accounts on this issue, and Robert E. Hudec, *Developing Countries in the GATT Legal System* (Aldershot, UK: Gower Publishing Co., 1987) figures prominently among them.

tariff rate amounted to an impediment for their export trade, in that it provided for non-discriminatory access to export markets irrespective of the level of development of the exporting country. They requested the establishment of a new mechanism that would allow them to access their export markets at preferential (when compared to developed countries' exports) tariff rates. This is what GATT Part IV, which was introduced in 1965, and the Enabling Clause enacted in 1979, were supposed to achieve.

We started with the affirmation that GATT disciplines were essentially 'one fit for all'. That is true, but not for lack of trying by some original negotiators to nuance the GATT framework. During the negotiation of the GATT, Lebanon had argued in favour of introducing tariff preferences for trade across developing countries, but its claim was not taken on board.[2] And, as Irwin et al.[3] note, India (before partition) had a hostile reaction when it was presented with the Suggested Charter, the harbinger of the GATT prepared by the US administration following consultations with the UK, and was asked to explain why: its criticism focused on MFN, arguing that this instrument was ill-equipped to deal with countries at different stages of development.[4]

One could trace various other sporadic initiatives to this effect in the early years of the GATT as well. The first time a comprehensive discussion on trade and development took place in the GATT though, was only in 1958 with the circulation of the Haberler report.

1.2 Haberler vs the Singer–Prebisch Thesis

Gottfried Haberler, Professor of Economics at Harvard, was requested by the GATT to examine the validity of claims by the less developed trading partners that the existing rules on trade liberalization would not necessarily work to their advantage. He ended up concluding that similar claims were not entirely unjustified.[5]

In his report, both the short- and the long-term trends in commodity prices and the factors influencing them were examined. The report concluded, inter alia, that existing protectionist policies in the agricultural sector by developed (industrialized) nations, as

[2] In the words of the Lebanese delegate: 'Members recognize that the development of industry in small nations is hampered by the lack of a sufficiently large market for manufactured goods. Consequently, the Organization shall give the most favourable consideration to any proposal for preferential tariff arrangements presented to it by small Member nations belonging to one economic region, aiming at the development of that region, with a view to releasing from their obligations under Chapter V.' This proposal did not concern North–South preferences, but rather, South–South preferences aiming at developing industries within regional blocks, see E/PC/T/C.6/W/25, 14.

[3] Irwin, Douglas A., Petros C. Mavroidis, and Alan O. Sykes, *The Genesis of the GATT* (New York City, NY: Cambridge University Press, 2008).

[4] Trade of course, is only part of a development strategy and there are inherent limits to how much development can be achieved through trade liberalization. This much should be obvious. Tupy, for example, reacting to how much the Doha Round can do to alleviate the problems that African states are facing (and obviously trying to bring some sense to those who saw the Round as the cure for all) eloquently stated that 'trade liberalisation as a cure for African poverty is often over-emphasized. The main causes of African impoverishment are internal'. Marian Tupy, 'Africa's War on Poverty Begins at Home', *The Financial Times*, 19 December 2005 (available at <http://www.ft.com>).

[5] GATT, *Trends in International Trade* (Geneva, 1958). Gottfried Haberler, of Harvard University, was one of the best trade economists of his time.

well as tariff escalation practices by many developed nations were contributing factors to lack of growth in developing countries.

It is worth recounting in this respect, that the United States had obtained a waiver in 1955, which allowed it to grossly subsidize its agricultural production over the subsequent years and essentially shield domestic producers from the challenges of international competition.[6]

The Haberler report made a series of recommendations to address the issue, and reduction of the existing protectionism was one of the measures suggested. Importantly, it sensitized the trading partners to the fact that not all gained alike from the existing regime; something needed to be done to address the concerns of those who were being left behind, essentially the producers of labour-intensive goods.

Haberler's report was not, alas, the only game in town. Hans Singer, a German Professor of Economics at Cambridge, and Raoul Prebisch, an Argentine economist, were advocating industrialization through import substitution policies as the safest way to development. The argument for import substitution was justified as the adequate response to what was termed 'terms of trade pessimism', the idea that exports of developing countries were progressing at a slower pace than total exports.[7]

Note that during that time, liberal market economies were discredited in the eyes of many observers, especially in developing countries, and a strong argument in favour of government-driven economies was falling onto fertile ground. Prebisch and Singer had a head start over Haberler in some quarters.[8]

The view that development essentially equalled industrialization (supported by the influence of terms of trade elasticity pessimism) provided developing countries with the necessary impetus to adopt negotiating strategies aimed at achieving preferential access in developed countries' markets: in a nutshell, their request was framed in terms of non-reciprocal preferential access to developed countries' markets. Thanks to

[6] The European Union (EU) barely existed in 1958 when Haberler issued his report. In subsequent years, however, the EU agricultural market remained hermetically closed to exports by developing countries: by adopting the notorious variable levies, whereby any imported product, when imported into the EU, would be burdened with a customs duty which equalled the difference between the world and the EU, exports to the lucrative European market were discouraged. As a result, the two most attractive markets were at the mercy of their domestic producers and not open to world competition. The subsequent enactment of the Multi-fibre Agreement (MFA) ensured that trade in textiles, yet another labour-intensive industry, would be limited in quantities. Limiting exports of agricultural and textile products worked to the huge disadvantage of developing countries.

[7] A related idea was what became known as 'elasticity pessimism': devaluation will improve trade balance assuming the Marshall–Lerner condition holds, that is, the sum of import and export demand elasticities exceeds one in absolute value. If elasticities are too low, other means (possibly QR) are needed to change an adverse trade balance. There is almost no evidence that the elasticities are so low, but that was the post-war fear of many developing countries, see Deepak Lal, *The Poverty of Development Economics* (Cambridge, MA: MIT Press, 2000).

[8] Their position has become known as the Singer–Prebisch thesis: by looking at examined data over a certain period of time, they concluded that the terms of trade for primary commodity exporters (the commodities where developing countries had comparative advantage) had a tendency to decline. The explanation for this was that, for manufactured (industrial) goods, the income elasticity of demand is greater than it is for farm goods: as incomes rise, the demand for the former increased more rapidly than did demand for the latter. Consequently, the argument goes, it is the structure of the market that creates inequality in the world system. For a number of reasons this thesis is no longer popular among economists.

economies of scale resulting from non-reciprocal preferential access of their products (so the argument goes), developing countries would gradually become more competitive in the production of industrial goods, which should be their objective anyway. Haberler lost then and there. Developing countries started submitting their requests for a negotiation on preferential tariff rates for developing countries only.

A Working Party on Commodities was established to review trends and developments in international commodity trade. The Singer–Prebisch thesis was reflected therein, as the quoted passage from the report in 1961 evidences:

> [I]n the long term, only the industrialization of the less-developed countries would enable these countries to overcome the present difficulties in their external trade; in turn, this industrialization and the economic development generally of the less-developed countries would only be achieved through an increase in their exports, including exports of manufactured and semi-manufactured goods. Direct investment and financial aid alone would not solve this problem.[9]

This victory opened the door to the introduction of GATT Part IV, the effective bifurcation of GATT disciplines, as we discuss in what follows.

2. Part IV and the Enabling Clause

2.1 First a waiver

During the Kennedy Round of international trade negotiations (1962–67) the Committee on Legal and Institutional Framework of GATT in Relation to Less-Developed Countries (one of the negotiating groups), worked on a chapter on trade and development. This chapter was finalized in a Special Session of the Contracting Parties, held from 17 November 1964 to 8 February 1965. It was annexed to the GATT as an amending protocol. It now appears as Part IV. Part IV came into effect on 27 June 1966, and consists of three new legal provisions: Principles and objectives (GATT Article XXXVI), Commitments (GATT Article XXXVII), and Joint action (GATT Article XXXVIII).

A look at the wording of each provision leaves the reader in no doubt that these were meant to be 'best endeavours' clauses aiming at opening the door to discriminatory (preferential) trade.

Following this negotiation, the feeling among developing countries was that Part IV had fallen short of substantively contributing to the development policies pursued, and that an additional mechanism was needed, at the very least, to make the language included in these provisions operational. This mechanism was, initially, a ten-year waiver allowing for preferential rates applicable to imports originating in developing countries only.

[9] GATT Doc. L/1656, 4 December 1961, published in GATT Doc. B.I.S.D. 10S/83ff., 93. During the 1955 review of the GATT, GATT Art. XXVIII was redrafted in the quest for import substitution policies which was largely reflected in GATT Art. XXVIII(c).

2.2 And then the Enabling Clause

Before the ten-year period ran out, the Enabling Clause took centre stage. The Enabling Clause reproduces the non-reciprocity idea, first embedded in GATT Article XXXVI.8, and provides for the possibility of making commitments in this vein.[10] The Panel on *EC—Tariff Preferences* recounts the advent of the Enabling Clause in the following terms:

> During the Second Session of UNCTAD, on 26 March 1968, a Resolution was adopted on expansion and Diversification of Exports and Manufactures and semi-manufactures of Developing Countries (Resolution 21 (II)). In this Resolution, UNCTAD agreed to the "early establishment of a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences which would be beneficial to the developing countries" and established a Special Committee on Preferences as a subsidiary organ of the Trade and Development Board, with a mandate to settle the details of the GSP arrangements. In 1970, UNCTAD's Special Committee on Preferences adopted Agreed Conclusions which set up the agreed details of the GSP arrangement. UNCTAD's Trade and Development Board took note of these Agreed Conclusions on 13 January 1970. In accordance with the Agreed Conclusions, certain developed GATT contracting parties sought a waiver for the GSP from the GATT Council. The GATT granted a 10-year waiver on 25 June 1971. Before the expiry of this waiver, the CONTRACTING PARTIES adopted a decision on "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries" (the "Enabling Clause") on 28 November 1979.

The Enabling Clause is thus, the decision of the GATT contracting parties, which allowed ('enabled') deviations from the MFN rate in favour of goods originating in developing countries to become a permanent feature of the GATT, and now the WTO, legal order.

Through the Enabling Clause, WTO members can now legitimately accord tariff preferences to developing countries: national GSP (Generalized System of Preferences) schemes are the vehicle to make this happen.[11] Of course, similar treatment is reserved

[10] A GSP is a list of products for which a tariff preference is accorded in favour of goods originating in developing countries. See, inter alia, Stefano Inama, 'Trade Preferences and the WTO Negotiations on Market Access: Battling for Compensation of Erosion of GSP, ACP and Other Trade Preferences or Assessing and Improving their Utilization and Value by Addressing Rules of Origin and Graduation' (2003) *Journal of World Trade* 37, 959–76; Alexander Keck and Patrick Low, *Special and Differential Treatment in the WTO: Why, When and How?* (Mimeo, 2003); Constantine Michalopoulos, *Developing Countries in the WTO* (Basingstoke: Palgrave, 2001); Dani Rodrik, *Making Openness Work: The New Global Economy and the Developing Countries* (Washington, DC: Overseas Development Council, 1999); T. N. Srinivasan, *Developing Countries and the Multilateral Trading System: GATT 1947 to Uruguay Round and Beyond* (Boulder, CO: Westview Press, 1998); Z. K. Wang and L. A. Winters, 'Putting "Humpty" Together Again: Including Developing Countries in a Consensus for the WTO' (2000) CEPR Policy Paper No. 4; and John Whalley, ed., *Developing Countries and the Global Trading System* (Ann Arbor, MI: University of Michigan Press, 1989).

[11] The best-known GSP schemes are the EU (discussed in Fabie Candau and Sébastien Jean, 'What are European Union Trade Preferences Worth for Sub-Saharan African and Other Developing Countries?'); the United States (Judith M. Dean and John Wainio, 'Quantifying the Value of US Tariff Preferences for Developing Countries'); the Japanese (Norio Komuro, 'Japan's Generalized System of Preferences'); the Canadian (Przemyslaw Kowalski, 'The Canadian Preferential Tariff Regime and Potential Economic

to developing countries that are members of the WTO and not to any developing country irrespective whether it has joined the WTO or not.

2.3 Lack of reciprocity underlined

GATT Article XXXVI constitutes the formal recognition that market access for products of export interest to developing countries has to be improved. It stops short, however, of prescribing measures that should be adopted to this effect. It does, on the other hand, provide the foundation for non-reciprocity, the underlying basis for the Enabling Clause, to come under the aegis of the GATT (§8):

> The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.

The Interpretative Note to this provision sheds some additional light:

> It is understood that the phrase "do not expect reciprocity" means, in accordance with the objectives set forth in this Article, that the less-developed contracting parties should not be expected, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs, taking into consideration past trade developments.

During the Kennedy Round, this provision was further interpreted as follows:

> There will, therefore, be no balancing of concessions granted on products of interest to developing countries by developed participants on the one hand and the contribution which developing participants would make to the objective of trade liberalization on the other and which it is agreed should be considered in the light of the development, financial and trade needs of developing countries themselves. It is, therefore, recognized that the developing countries themselves must decide what contributions they can make.[12]

GATT Article XXXVII is a general clause recommending various actions that developed countries should take in order to help promote issues of interest to developing countries: chief among them, the spur to reduce the gap between (high) barriers on processed goods, and (low) barriers on primary products: this is, of course, tariff escalation.

The validity of this argument though, is at best doubtful: in this scenario (high tariffs for processed goods, low tariffs for primary goods), the problem seems to be the high tariff on processed goods, and not the gap in the level of tariffs between processed and primary goods. The remaining part of this provision deals with issues that were further

Impacts of its Erosion'); and the Australian (Douglas Lippoldt, 'The Australian Preferential Tariff Regime'), all in Bernard M. Hoekman, Will Martin, and Carlos A. Primo Braga, eds., *Trade Preference Erosion, Measurement and Policy Response* (Washington, DC: Palgrave Macmillan and the World Bank, 2009), at 65–102; 29–64; 103–30; 131–72; 173–218, respectively.

[12] GATT, COM.TD/W/37, 9.

detailed in other agreements. For example, developed countries, when imposing countervailing duties (CVD) or antidumping (AD) duties, or introducing safeguard measures, were to 'have special regard to the trade interests' of developing countries and 'explore all possibilities of constructive remedies before applying such measures'. In the AD Agreement concluded during the Uruguay Round, WTO members agreed to transform this into a binding legal obligation. It has since been consistently interpreted as an obligation to examine the feasibility of introducing price undertakings on dumped imports originating in developing countries, before AD duties are eventually imposed.

GATT Article XXXVIII was meant to provide the institutional vehicle that would make the best endeavours clauses reflected in the two aforementioned provisions operational: institutional arrangements for furthering the objectives of Part IV should be made, collaboration to this effect with the United Nations and its organs and agencies was envisaged, and some monitoring of the rate of growth of the trade of developing countries should be introduced. This is where the Enabling Clause kicks in.

3. The Enabling Clause in Practice: The GSP Schemes

3.1 The key elements

The most important features of the Enabling Clause may be summarized as follows:[13]

1. It announces the general principle that deviations from MFN are allowed for products originating in developing countries (§1);
2. Concessions (§2) can be expressed in tariff (§2(a)), as well as non-tariff terms (§2(b));
3. It provides the legal basis for developing countries to form preferential trade agreements between themselves while respecting less onerous requirements than those established by GATT Article XXIV (§2(c));
4. It distinguishes between developing countries and least developed countries (LDCs), the latter being a sub-group of the former, allowing for additional (to those granted to developing countries) preferences for LDCs (§2(d));
5. Measures coming under its purview must be designed to correspond to the 'development, financial and trade needs of developing countries' (§3(c));
6. WTO members that have recourse to measures coming under the purview of the Enabling Clause must notify the WTO membership, and consult with them, whenever appropriate (§4);
7. Donors should not expect reciprocity from beneficiaries (§5);
8. LDCs should not, in general, be expected to make commitments that might jeopardize their development, financial, and trade needs (§8); and

[13] Decision on Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries, of November 28, 1979 (GATT Doc. L/4903), GATT B.I.S.D. 26S/203ff.

9. Graduation is established in terms of a reflected acknowledgement that developing countries are expected to participate more fully in the multilateral trading system as long as their economic situation improves (§7).[14]

3.2 The Enabling Clause in the WTO legal order

The Appellate Body, in its report on *EC—Tariff Preferences*, held that the Enabling Clause has become an integral part of the GATT, by virtue of GATT 1994 Article 1(b)(iv). In the same report it notes that, since the Enabling Clause enables WTO members to grant tariff preferences to a sub-set of the WTO membership (namely, developing countries), it constitutes a legal exception to GATT Article I GATT (§99). The legal implication, in the Appellate Body's view, is that the Enabling Clause takes precedence over GATT Article I (§102).

As to the allocation of the burden of proof, the Appellate Body, reversing the Panel in this respect, held that it is insufficient for a complaining party, when challenging a measure taken pursuant to the Enabling Clause, to simply claim violation of GATT Article I (§110). Due process considerations (§113) require that the complaining party:

> *identify* those provisions of the Enabling Clause with which the scheme is allegedly inconsistent, without bearing the burden of *establishing* the facts necessary to support such inconsistency [§115, emphasis in the original].

Identification, of course, does not amount to an obligation to respect the standard of review associated with a claim under the Enabling Clause. The soundness of this approach can of course, be questioned. It would probably have made better sense for the Appellate Body to go all the way and construct the Enabling Clause not as an exception to GATT Article I, but as a self-standing obligation.

WTO members apply one set of tariffs to imports from developed nations, and another on imports originating in developing countries. Complainants will carry a similar burden of proof irrespective of whether they attack violations of MFN, or of the Enabling Clause. More than anything else, the functionality of the Appellate Body innovation in the allocation of the burden of proof here is hard to fully grasp.

3.3 Who are the beneficiaries? Developing countries and LDCs

WTO members (donors) can, but do not have to, provide preferences. If they decide to do so, then they must respect the Enabling Clause. The letter and the spirit of the Enabling Clause make it clear that preferences can be granted to developing countries (and not to other developed countries). It does not, however, lay down any specific criteria to decide which WTO members will be classified as developing countries.

[14] The terminology is a bit confusing in this respect since the Enabling Clause here refers to 'less developed', whereas before the terms used were developing and least developed countries. The fact that in §7 it refers to less developed in the same context as developed countries should leave one in no doubt that the terms 'less developed' and 'developing' are used interchangeably.

Developing countries in the WTO are designated on the basis of the 'self-selection' principle (itself, an expression of the principle of sovereignty).

There is no doubt as to the identity of the LDCs, a sub-set of the developing countries' group as per §2(d) of the Enabling Clause: the WTO recognizes as LDCs those countries which have been designated as such by the UN.

There are currently forty-eight LDCs on the UN list,[15] thirty-three of which are WTO members: Angola, Bangladesh, Benin, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, the Democratic Republic of the Congo, Djibouti, Gambia, Guinea, Guinea Bissau, Haiti, Lesotho, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Senegal, Sierra Leone, Solomon Islands, Tanzania, Togo, Uganda, Vanuatu, and Zambia.[16] Ten more LDCs are currently negotiating their accession to the WTO: Afghanistan, Bhutan, Comoros, Equatorial Guinea, Ethiopia, Laos, Liberia, Sao Tomé and Principe, Sudan, and Yemen. Geographically, thirty-three of the forty-eight are located in Africa, fourteen in Asia, and only one (Haiti) in the Caribbean.

Preferences for LDCs vary across donors. The EU has its own initiative in place aiming to help LDCs, the so-called EBA (Everything But Arms). In February 2001, first, the Council adopted Regulation (EC) 416/2001, granting duty-free access to imports of all products from LDCs, except arms and ammunitions, without any quantitative restrictions (with the exception of bananas, sugar, and rice for a limited period). EBA was later incorporated into the GSP Council Regulation (EC) No. 2501/2001. The Regulation foresees that the special arrangements for LDCs should be maintained for an unlimited period of time and not be subject to the periodic renewal of the EU GSP.[17] There is no absolute overlap between the list of LDCs and the EBA beneficiaries.

[15] <http://unctad.org/en/pages/ALDC/Least%20Developed%20Countries/UN-list-of-Least-Developed-Countries.aspx>. In this web page we find the UN criteria for including a country among the LDCs. We quote: 'In its latest triennial review of the list of LDCs in 2009, the UN Committee for Development Policy used the following three criteria for the identification of the LDCs: (i) A low-income criterion, based on a three-year average estimate of the gross national income (GNI) per capita (under $905 for inclusion, above $1,086 for graduation); (ii) A human capital status criterion, involving a composite Human Assets Index (HAI) based on indicators of: (a) nutrition: percentage of population undernourished; (b) health: mortality rate for children aged five years or under; (c) education: the gross secondary school enrolment ratio; and (d) adult literacy rate; and (iii) An economic vulnerability criterion, involving a composite Economic Vulnerability Index (EVI) based on indicators of: (a) population size; (b) remoteness; (c) merchandise export concentration; (d) share of agriculture, forestry and fisheries in gross domestic product; (e) homelessness owing to natural disasters; (f) instability of agricultural production; and (g) instability of exports of goods and services. To be added to the list, a country must satisfy all three criteria. In addition, since the fundamental meaning of the LDC category, i.e. the recognition of structural handicaps, excludes large economies, the population must not exceed 75 million. To become eligible for graduation, a country must reach threshold levels for graduation for at least two of the aforementioned three criteria, or its GNI per capita must exceed at least twice the threshold level, and the likelihood that the level of GNI per capita is sustainable must be deemed high.'

[16] Graduation applies here. The UN removed, as of 1 January 2008, Cape Verde from this list, see UN GA Res. A/Res/59/210 of 20 December 2004. Donors followed suit: the EU, for example, removed Cape Verde from its list of LDC beneficiaries of preferences through Regulation 1547/2007 of 21 December 2007 published in the Official Journal (OJ) of the EU L 337/70.

[17] The current EU GSP is reflected in Regulation 732/2008 (22 July 2008) published in the Official Journal (OJ) of the EU, L 211/1.

The EU has removed Myanmar from the list of beneficiaries following charges that Myanmar was violating the ILO (International Labour Organization) conventions on forced labour (Council Regulation 552/97). The EU has kept Maldives among the beneficiaries, although as of 1 January 2011, Maldives does not figure among the LDCs.[18]

Unilateral declarations (to the effect that a WTO member is a developing country) can, in principle, be challenged before a WTO Panel. No formal challenge has been launched so far in this context. Following the advent of the WTO, we have witnessed more detailed discussions on this issue than before. While negotiating on the implementation of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), the United States and the EU voiced their desire that WTO members like Singapore, Korea, and Hong Kong, China be considered as developed nations at least for the purposes of complying with TRIPs. The discussions in the TRIPs Council evidence that the principle of self-election as such was not questioned.[19] To cite another example, the EU delegate, during the discussions before the Dispute Settlement Body (DSB) regarding the adoption of the Appellate Body report on *Korea—Various Measures on Beef*:

> noted with surprise that Korea had been treated as a developing country for the purposes of the Agreement on Agriculture. Although this issue did not seem to have been in dispute, the EC was compelled to underline its disagreement with Korea's self-characterization as a developing country.[20]

Sometimes negotiated solutions lead to outcomes that are hardly reconcilable with the text of the relevant statute. In the Chinese Protocol of Accession, for example, we read that the *de minimis* threshold for calculation of the Aggregate Measurement of Support (AMS) in accordance with Article 6.4 of the AoA should be 8.5 per cent, when the corresponding numbers are 10 per cent for developing, and 5 per cent for developed countries. Thanks to this compromise reached, no WTO member challenged the status of China as a developing country.

Since development is an ongoing process, one would normally expect the group of developing countries to be dynamic, and not static. Indeed §7 of the Enabling Clause as mentioned earlier, says as much (referring to 'graduation'). Several discussions have taken place within the GATT/WTO aiming to 'beef up' the language included in this provision, but, alas, none of them has been conclusive.[21] As things stand, exclusion from the group of beneficiaries of tariff preferences remains largely at the discretion of donor countries.

There is legal certainty as to the identity of LDCs. Developing countries are defined by virtue of the self-election principle. Donors can challenge invocations. De facto, in the WTO world, OECD members are part of the camp of developed, and non-OECD, of developing countries.

[18] Commission Regulation (EU) 1127/2010 of 3 December 2010, published in the Official Journal (OJ) of the EU, L 318/15.

[19] WTO Doc. IP/C/M/8, 14 August 1996, 58ff.

[20] WTO Doc. WT/DSB/M/96, 22 February 2001, 14.

[21] See, for example, GATT Doc. C/M/152.

3.4 Distinguishing beyond the developing countries/LDCs dichotomy

In *EC—Tariff Preferences*, the Panel and the Appellate Body faced the following question: is the distinction between developing countries and LDCs the only permissible distinction across beneficiaries that could provide the basis for the level of preferences granted? Or could other distinctions be lawfully used to this effect and purpose? And if so, where could one look for inspiration?

The narrow question before the Panel was whether the EU had legitimately excluded India from some of its preferences. The wider policy issue was whether donors can make distinctions between beneficiaries other than the distinction between developing countries and LDCs operated in §2(d) of the Enabling Clause.

The facts in this dispute were as follows: India and Pakistan both benefited from the EU GSP. Pakistan, however, received extra preferences because it qualified under the so-called Drug Arrangements, a scheme aimed at compensating those WTO members that had adopted active policies against drug production and trafficking. India complained that, by discriminating in favour of Pakistani imports, the EU was in violation of GATT Article I, a claim upheld by the Panel (§7.60).

The Panel went on to examine to what extent recourse to the Enabling Clause could be offered as justification. In the Panel's view, the Enabling Clause requires that developed countries must, by virtue of the term 'non-discriminatory' featuring in footnote 3 of the Enabling Clause, give identical tariff preferences to all developing countries.[22] The Appellate Body reversed the Panel's findings in this respect. It started its analysis (§157) by pointing to the terms used in §3(c) of the Enabling Clause, which specifies that 'differential and more favourable treatment' provided under the Enabling Clause:

> ... shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.

In its view, this paragraph made it plain that development needs are not necessarily shared to the same extent by all developing countries (§162).[23] As a result, a donor

[22] The Panel accepted that LDCs could benefit from additional preferences in light of the unambiguous wording of the Enabling Clause in this respect.

[23] The Appellate Body suggests that the drafters could easily have inserted the term 'all' before developing countries, if they really wanted to drive home the point that no discrimination across developing countries is permitted. Grossman and Sykes take issue with this statement arguing that the Appellate Body has treated silence in a very inconsistent manner in its case law. They argue that, by the same token, the drafters could have inserted the term 'certain' before developing countries, if they wanted to allow for discrimination. Gene M. Grossman and Alan Sykes, 'A Preference for Development: The Law and Economics of GSP' (2005) *World Trade Review* 4, 41–68. The fact that they did not is probably equally relevant as an indicator of their intent. They take the view that based not on silence, but on actual expression, the Enabling Clause makes one distinction only between developing and LDCs. This is the only relevant distinction, in their view. Howse has defended the view that neither the Panel nor the Appellate Body should have entered into any discussion of the issue at all since, in his view, the Enabling Clause is not justiciable to start with. Robert Howse, 'India's WTO Challenge to Drug Enforcement Conditions in the European Community GSP: A Little Known Case with Major Repercussions for "Political" Conditionality in US Trade Policy' (2003) *Chicago Journal of International Law* 4, 385–405.

wishing to do justice to this provision might have to provide tailor-made (differential) treatment to different beneficiaries; in this case, the scheme would not *ipso facto* (for example, because of the differentiation) be judged to be discriminatory since, as the quoted passage makes plain, differentiation might be warranted, indeed, necessary in order to respect the *effet utile* of this provision (§165). Additional preferences cannot thus, be outright excluded (§169). It went on to rule that:

> in granting such differential tariff treatment, however, preference-granting countries are required, by virtue of the term "non-discriminatory", to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the "development, financial and trade needs" to which the treatment in question is intended to respond [§173].

Applying its test to the specific case, the Appellate Body found that the Drug Arrangements were not WTO-consistent, only because the EU had included in its scheme a closed list of beneficiaries (§§180 and 187). In §183, we find the core of the Appellate Body's argument:

> What is more, the Drug Arrangements themselves do *not* set out any clear prerequisites—or "objective criteria"—that, if met, would allow for other developing countries "that are similarly affected by the drug problem" to be *included* as beneficiaries under the Drug Arrangements. Indeed, the European Commission's own Explanatory Memorandum notes that "the benefits of the drug regime . . . are given without *any* prerequisite." Similarly, the Regulation offers no criteria according to which a beneficiary could be *removed* specifically from the Drug Arrangements on the basis that it is no longer "similarly affected by the drug problem". Indeed, Article 25.3 expressly states that the evaluation of the effects of the Drug Arrangements described in Articles 25.1(b) and 25.2 "will be without prejudice to the continuation of the [Drug Arrangements] until 2004, and their possible extension thereafter." This implies that, even if the European Commission found that the Drug Arrangements were having no effect whatsoever on a beneficiary's "efforts in combating drug production and trafficking", or that a beneficiary was no longer suffering from the drug problem, beneficiary status would continue. Therefore, even if the Regulation allowed for the list of beneficiaries under the Drug Arrangements to be modified, the Regulation itself gives no indication as to how the beneficiaries under the Drug Arrangements were chosen or what kind of considerations would or could be used to determine the effect of the "drug problem" on a particular country. In addition, we note that the Regulation does not, for instance, provide any indication as to how the European Communities would assess whether the Drug Arrangements provide an "adequate and proportionate response" to the needs of developing countries suffering from the drug problem [emphasis in the original].

For its scheme to be WTO-consistent, the EU would have to modify its Regulation so as to ensure that it reflects:

> criteria or standards to provide a basis for distinguishing beneficiaries under the Drug Arrangements from other GSP beneficiaries [§188].

It follows from this case law that WTO members can distinguish between recipients of preferences between developing countries beyond the distinction between developing countries and LDCs included in the Enabling Clause, provided that their distinctions correspond to (objective) criteria.

The Appellate Body, alas, did not provide any guidance as to how we should understand the term '(objective) criteria and standards' that it first employed in *EC—Tariff Preferences*. All we know is that distinctions are possible but have no clue, not even an indicative list, as to how they should be made. We do know that a closed list cannot meet this criterion; quite reasonably so, since countries that aspire to emulate those included in the list of beneficiaries will not be included. A closed list thus does not meet the Appellate Body standard for objectivity since countries in a similar position will be treated differently.

The EU expanded on its prior practice: it had originally included Sri Lanka in its list for GSP+ preferences, although Sri Lanka is no LDC. In a press release dated 15 December 2009 by the Commission of the EU (DG Trade),[24] however, it was announced that the EU would remove with immediate effect Sri Lanka from the list of GSP+ beneficiaries for failure to implement three UN Human Rights Conventions (the International Covenant on Civil and Political Rights (ICCPR); the Convention against Torture (CAT); and the Convention on Rights of the Child (CRC)).

Recall that the criteria for benefiting under the Drugs Arrangements scheme had been established unilaterally. The Appellate Body did not question the EU's discretion to unilaterally draw objective criteria and standards. It is at best debatable, nonetheless, whether donors have (any) incentives to adopt criteria that will promote development of the recipients, and not simply their own social preferences. It might sound cynical, but was not the EU addressing (in part at least) its own domestic problems through the Drug Arrangements? Moreover, opening up the door to all sorts of distinctions might undo the prioritization of development options that the recipients have decided for themselves, since the perks might be too good to turn down.[25] This is an area where some additional thinking is required before we embark on the exercise as currently designed by the WTO adjudicating bodies.

In 1999, WTO members adopted a waiver that allows developing countries

> to provide preferential tariff treatment to products of least-developed countries, designated as such by the United Nations, without being required to extend the same tariff rates to like products of any other Member.[26]

This waiver allows for one-way preferential treatment for products originating in LDCs, and it should not be confused with preferential trade agreements across developing countries. Recall that the Enabling Clause provides the basis for facilitating preferential

[24] <http://trade.ec.europa.eu/doclib/docs/2012/december/tradoc_150164.pdf> at 16.

[25] Diverging views have been expressed on this matter, see, inter alia, Paul Brenton, 'Integrating the Least Developed Countries into the World Trading System: The Current Impact of EU Preferences under Everything but Arms' (2003) *Journal of World Trade* 37, 623–46; Bernard M. Hoekman, C. Michalopoulos, and L. Alan Winters, 'More Favorable and Differential Treatment of Developing Countries: Towards a New Approach in the WTO' (2004) *The World Economy* 27(4): 481–506; Dani Rodrik, *What is Wrong with the (Augmented) Washington Consensus?* (Mimeo, 2002). Available at <http://www.sopde.org/discussion.htm>.

[26] WTO Doc. WT/L/304 of 17 July 1999.

trade agreements across developing countries (usually referred to as 'South–South cooperation') that do not have to follow the requirements embedded in GATT Article XXIV. According to §2(c) of the Enabling Clause:

> Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another.

This provision does not explain the specifics of the test that will be applied when a preferential trade agreement (PTA) among developing countries is examined. Following the advent of the Transparency Mechanism in 2006, there is a standard procedure applicable to all PTAs, irrespective of whether they have been notified under GATT Article XXIV, GATS Article V, or §2(c) of the Enabling Clause; the only difference is that, whereas it is the Committee on Regional Trade Agreements (CRTA) that is notified of the first two, it is the Committee on Trade and Development (CTD) that is notified of the latter. There are very few completed reports, such as the report concerning the Bangkok Agreement, and hence no meaningful conclusion can be drawn on the nature of multilateral review of South–South cooperation.[27] To date, no direct legal challenge has been raised against South–South preferences.[28]

Finally, as mentioned, non-tariff preferences are possible as well. To our knowledge, it is in multilateral agreements that we see evidence of similar provisions and not in GSP schemes. We turn to this discussion in the following section.

4. Other Provisions on Special and Differential Treatment

There are numerous provisions in the covered agreements that qualify as special and differential treatment-type of provisions. This is how a document prepared by the WTO Secretariat has classified these provisions:

1. Provisions aimed at increasing the trade opportunities of developing country members;
2. Provisions under which WTO members should safeguard the interests of developing country members;
3. Flexibility of commitments, of action, and use of policy instruments;
4. Transitional time periods;
5. Technical assistance; and
6. Provisions relating to LDC members.[29]

In essence, these provisions aim to improve the position of developing countries within the WTO either by introducing 'lighter' disciplines that are applicable to

[27] GATT Doc. B.I.S.D. 25S/109.
[28] Jaime De Melo, 'Regionalism and Developing Countries: A Primer' (2007) *Journal of World Trade* 41, 347–66.
[29] WTO Doc. WT/COMTD/W/77/Rev.1 of 21 September 2001.

developing countries only, or by increasing the embedded expertise of developing countries on WTO-related issues. There is an institutional acknowledgement that participation in the WTO also depends on whether there is embedded expertise in national administrations on WTO-related issues, and there is empirical evidence to support this perception.[30]

Various WTO members participate in numerous other initiatives outside the WTO aiming to improve the position of developing countries in the WTO. The Advisory Centre for WTO Law (ACWL) is the best-known initiative of the sort, and it aims to provide legal expertise to developing countries at non-market (i.e., subsidized) rates.[31]

It is difficult to make a general pronouncement on the merits of all special and differential provisions, since they constitute a heterogeneous group.

If at all, one can side with Low's reservations[32] regarding the justification of an approach that preaches 'one size fits all'. It is quite true that developing countries present a very diverse group of countries which is indeed becoming increasingly diverse over the years. The various provisions echo the very basic developing countries/LDCs distinction first reflected in the Enabling Clause. Rodrik[33] has forcefully argued in favour of adding to the existing arsenal, pointing to the very limited usefulness (and even total uselessness) of some of the existing provisions: technical capacity, for example, as nowadays practised, has come under a lot of criticism, a point to which we return later.

On the other end of the spectrum, Hoekman[34] warns against the dangers of an over-expanded class of provisions coming under the heading 'special and differential treatment': the WTO could become an irrelevant policy prescription for beneficiaries and thus, all gains from trade liberalization and participation in the negotiating process could be severely undermined. It seems that too much is the wrong medicine, but the existing measures are not good medicine either. The WTO has embarked, explicitly and implicitly, in a re-evaluation of its development tools in the context of the Doha Development Agenda (DDA), a point to which we return in what follows.

5. Institutional Provisions

In 1964, the GATT undertook its first substantive initiative to provide an institutional infrastructure to its provisions regarding special and differential treatment: the GATT contracting parties agreed on the establishment of the CTD. Its mandate was to review

[30] Håkan Nordström, 'Participation of Developing Countries in the WTO—New Evidence Based on the 2003 Official Records' in George A. Bermann and Petros C. Mavroidis, eds., *WTO Law and Developing Countries* (New York City, NY: Cambridge University Press, 2007) 146–85.

[31] Meagher discusses its mandate *in extenso*. Niall Meagher, 'Representing Developing Countries in WTO Dispute Settlement Proceedings' in Bermann and Mavroidis, eds., *WTO Law and Developing Countries* (2007) 213–26. The WTO also provides similar services, albeit in a more limited manner, by making two legal experts available to developing countries on a part-time basis (DSU Art. 27.2).

[32] Patrick A. Low, 'Is the WTO Doing Enough for Developing Countries?' in Bermann and Mavroidis, eds., *WTO Law and Developing Countries* (2007) 324–57.

[33] Dani Rodrik, *The Global Governance of Trade as if Development Really Mattered* (New York, NY: UNDP, 2001).

[34] Bernard M. Hoekman, 'Operationalizing the Concept of Policy Space in the WTO: Beyond Special and Differential Treatment' (2005) *Journal of International Economic Law* 8, 405–24.

the application of the provisions of Part IV. Article IV.7 of the Agreement Establishing the WTO, which describes the current mandate of the CTD provides:

> The Ministerial Conference shall establish a Committee on Trade and Development . . . which shall carry out the functions assigned to them by this Agreement and by the multilateral trade agreements, and any additional functions assigned to them by the General Council. . . . As part of its function, the Committee on Trade and Development shall periodically review the special provisions in the multilateral trade agreements in favour of LDC members and report to the General Council for appropriate action.

Eventually, the CTD evolved into the forum where discussion on trade and development in the widest possible connotation of the term takes place under the aegis of the WTO. It is a multi-task institution in which all WTO members participate. It is a depository for all GSP schemes, and also the forum where the notification of and the discussion about preferential arrangements under §2(c) of the Enabling Clause takes place.[35] It supervises the implementation of provisions favouring developing countries (special and differential treatment), and it issues guidelines for technical cooperation.

The CTD serves as a focal point for consideration and coordination of technical assistance work on development in the WTO and its relationship to development-related activities in other multilateral agencies. It further adopts measures aimed at increasing participation of developing countries in the trading system, paying particular attention to the position of LDCs.

At the same time (1964), the International Trade Centre (ITC) was established, with the aim of promoting trade in developing countries. The ITC became later a joint agency of United Nations Conference on Trade and Development (UNCTAD) and the GATT (and eventually the WTO). In 1998, the WTO together with UNCTAD and the ITC established the Common Trust Fund, meant to finance technical capacity in developing countries.

The mandate of the CTD and, more generally, the involvement of the WTO in development-related issues has widened over the years and extended beyond the 'classic' trade content it originally was endowed with. The contribution of the world trading system towards development was, in the minds of the original framers of the GATT, unidimensional: non-discriminatory trade liberalization; following the discussion in the late fifties, the rules of the trading system were amended so as to make room for discriminatory (preferential) trade for goods originating in developing countries; and later, following the Uruguay Round, the discussion moved to non-trade development-related issues.

It is difficult to be precise about the starting point of this negotiation. It is clear nevertheless, that at the Doha Ministerial Conference, in November 2001, trade ministers mandated the CTD to identify which special and differential treatment provisions are mandatory, and to consider the implications of making mandatory those which are currently non-binding. During this meeting, the Sub-Committee on LDCs saw the light of the day: this institution, in which all WTO members participate,

[35] WTO Docs. WT/L/671 and 672 of 14 December 2006.

focuses on the implementation of the WTO Work Programme for the LDCs, namely: market access for LDCs; trade-related technical assistance and capacity building initiatives for LDCs; providing, as appropriate, support to agencies assisting with the diversification of LDCs' production and export base; mainstreaming, as appropriate, into the WTO's work the trade-related elements of the LDC-III Programme of Action, as relevant to the WTO's mandate; participation of LDCs in the multilateral trading system; accession of LDCs to the WTO; and follow-up to WTO Ministerial Decisions/ Declarations.[36]

The WTO Work Programme for the LDCs is the platform that essentially placed the WTO in the wider inter-institutional discussion on poverty reduction and development (in which, notably, the World Bank participates). Sure the WTO can only, by reason of its mandate, have limited impact since trade is but a component (and often a small one) in the development discourse. This initiative, nonetheless, gave the WTO much more visibility in wider than trade policy discussions.

At the Hong Kong Ministerial Conference (2005), the CTD adopted five decisions in favour of the LDCs, including a decision to grant duty-free and quota-free market access for at least 97 per cent of LDC exports. It has further been quite active in implementing a number of development-related initiatives, such as the WTO Work Programme for Small Economies. The Doha Declaration mandated the WTO General Council to examine this issue, and to make recommendations regarding measures that could improve the integration of small economies into the multilateral trading system. On 1 March 2002, the WTO General Council agreed that:

> The question of small economies would be a standing agenda item of the General Council; The Committee on Trade and Development (CTD) would hold Dedicated Sessions on this question and report regularly to the General Council.[37]

In similar vein, §55 of the Hong Kong Ministerial Declaration instructs the CTD to intensify its work on commodity issues in cooperation with other relevant international organizations and to report to the General Council with possible recommendations.

The CTD has also been active in promoting electronic commerce,[38] and Aid for Trade. Besides the CTD, during the Doha Round, ministers set up working groups on Trade, Debt and Finance, and on Trade and Technology Transfer, the former under the influence that the discussion on the impact of the financial crisis in the first years of the new century would have had on trade liberalization.

The WTO now cooperates with other international organizations in programmes of common interest. The two most prominent initiatives aimed at providing technical assistance to developing countries are the Integrated Framework (IF) and the Joint

[36] WTO Doc. WT/COMTD/LDC/11 of 13 February 2002. This Work Programme was adopted shortly after the initiation of the Doha Round and was thought to be one of the main pillars of the ongoing negotiations since the Round aimed to address, as a matter of priority, development-related issues, hence the denomination Doha Development Agenda (DDA). There is of course only so much that one can do through trade and its overall contribution to development should not be exaggerated.

[37] The CTD issued a report to this effect, see WTO Doc. WT/COMTD/SE/5, 29 September 2006.

[38] WTO Doc. WT/L/274, of 30 September 1998.

Integrated Technical Assistance Programme (JITAP).[39] The IF, or EIF (Enhanced Integrated Framework, as it became in 1997),[40] is an inter-agency coordination mechanism for the delivery of technical assistance, promotion of economic growth and sustainable development, and more generally in helping to lift LDCs from the poverty trap, among six multilateral agencies—the WTO, ITC, IMF, UNCTAD, United Nations Development Programme (UNDP), World Bank, in partnership with bilateral donors and LDC beneficiaries. Note that only LDCs can take advantage of the IF facility. The WTO serves as coordinator of the IF and accommodates a Secretariat, with a view to taking maximum advantage of each agency's expertise, to ensure optimal coordination. The inter-agency aspect of the coordination is primarily dealt with by the Inter-Agency Working Group (IAWG).[41] The IF aims to place trade in the context of a wider development agenda. The revamped IF is currently being extended to the following countries: Cambodia, Madagascar, Mauritania, Burundi, Djibouti, Eritrea, Ethiopia, Guinea, Lesotho, Malawi, Mali, Nepal, Senegal, and Yemen. Roughly between forty and fifty LDCs in total have benefited from it.

The Members of the WTO have approved the work of the IF. During the Doha Ministerial Conference, they decided to reinforce the IF, as illustrated by §43 of the Doha Ministerial Conference Decision:

> We endorse the Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries (IF) as a viable model for LDCs' trade development. We urge development partners to significantly increase contributions to the IF Trust Fund and WTO extra-budgetary trust funds in favour of LDCs. We urge the core agencies, in coordination with development partners, to explore the enhancement of the IF with a view to addressing the supply-side constraints of LDCs and the extension of the model to all LDCs, following the review of the IF and the appraisal of the ongoing Pilot Scheme in selected LDCs. We request the Director-General, following coordination with heads of the other agencies, to provide an interim report to the General Council in December 2002 and a full report to the Fifth Session of the Ministerial Conference on all issues affecting LDCs.[42]

More recently, echoing the Decision above and following active monitoring of its activities, the WTO decided to redirect the IF towards the preparation of poverty reduction strategic papers and towards reducing the observed implementation gap (between IF prescriptions and follow-up at the national level).[43]

[39] For details concerning the operation of these programmes, see WTO Doc. WT/COMTD/W/102 of 16 July 2002.

[40] The move from IF to EIF signalled a wider portfolio for the established entity and substantial 'ownership' by the beneficiaries (LDCs) who would now have more of a say in shaping the agenda and the programmes that should be financed.

[41] IF coordination further rests with the Integrated Framework Steering Committee (IFSC) and National IF Steering Committees. The IFSC consists of representatives of the six agencies, all donors and LDC beneficiaries, and provides *overall* policy guidance on the functioning of the IF. It meets, in principle, three times a year. The task of coordination at the country level rests with the beneficiary country itself, through the establishment of a national IF Steering Committee, and with the support of a lead donor.

[42] WTO Doc. WT/IFSC/1 of 28 February 2002.

[43] WTO Doc. WT/IFSC/W/15 of 29 June 2006.

The JITAP, on the other hand, is a multi-country capacity building programme implemented jointly by ITC, UNCTAD, and the WTO. Following JITAP I, JITAP II was launched in February 2003, and originally covered sixteen African countries,[44] which included the original eight JITAP countries plus an additional eight countries selected on the basis of criteria determined jointly by the implementing agencies and the donors to the programme. The eight original JITAP countries[45] have since 'graduated' from the programme as of 31 December 2005. The JITAP aims at building capacity and strengthening the national knowledge base on the multilateral trading system. Its objective is to ensure more effective participation in trade negotiations; better implementation of the WTO agreements; informed formulation of trade-related policies; improved supply capacity and market knowledge of exporting and export-ready enterprises, to derive benefits from business opportunities resulting from better market access under the multilateral trading system.

In 2006, JITAP consolidated the implementation of the various modules in the remaining eight JITAP countries.[46] The JITAP Common Trust Fund Steering Group was to determine before the end of 2007 whether the commissioning of a future phase of JITAP was necessary. JITAP II ended in June 2007 with the nature and scope of its future phase not agreed between the agencies and the donors to the programme. JITAP III never saw the light of day. The donors felt that the IF and the new Aid for Trade initiative that was successfully negotiated during the Doha Round would take care of the issues that JITAP was supposed to address.

In Bali (December 2013) during the Ministerial Conference, two members renewed their commitment to completing the DDA. The only tangible outcome, however, was the Agreement on Trade Facilitation which does contain a strong development component (by facilitating trade especially in ports of entry with little infrastructure), but does not go far enough. It is limited, at the time of writing to cooperation across customs.

6. The Limits of WTO Involvement

The analysis in this chapter points to two conclusions: first the 'model' of the contribution to development by the world trading system has been revised; second, the WTO has embarked on an international coalition to promote development. It is this second part that merits a few lines. Intellectually though, the two points are linked, in the sense that the second is most likely the consequence of the first.

Why did we argue that the trading system has changed its approach? GSP schemes have not managed to achieve what they were supposed to do. There are dozens of empirical papers pointing to the failings of this instrument. Grossman and Sykes[47] provide a comprehensive overview of the literature. There is quasi unanimity between

[44] Benin, Botswana, Burkina Faso, Cameroon, Côte d'Ivoire, Ghana, Kenya, Malawi, Mali, Mauritania, Mozambique, Tanzania, Tunisia, Uganda, Senegal, and Zambia.

[45] Benin, Burkina Faso, Côte d'Ivoire, Ghana, Kenya, Tanzania, Tunisia, and Uganda.

[46] Botswana, Cameroon, Malawi, Mali, Mauritania, Mozambique, Senegal, and Zambia.

[47] Grossman and Sykes, 'A Preference for Development', n. 23 at 41–68.

analysts that GSP schemes have hardly helped the integration of developing countries into the world trading system.

There is no paucity of literature regarding the explanatory variables of the failure. More persuasively than anyone else, Bagwell and Staiger[48] have pointed to an obvious and yet remarkably overlooked point: developing countries do not participate at all in the shaping of the lists of tariff preferences. They are absent from this discussion, which typically involves two partners only; the national administration and producers of the donor countries. They would, of course, draw up lists thinking in terms of promoting national interest. Altruistic motives might creep in into this calculation, but they are not decisive.

The move to 'Aid for Trade' was at the very least an acknowledgement that tariff preferences are not, or, at the very least, are not by themselves the tool that will bring about development. Trade is but one of the components that helps to develop a state.

Consequently, the need to rally different competences behind promotion of development is a necessity. This is what led the WTO to its coalition with the World Bank, UNCTAD, and other institutions. And it is this coalition that is now in charge of Aid for Trade.

Aid for Trade cares of course about a number of areas that are totally beyond the mandate of the WTO. Financing infrastructure, for example, is an area where the World Bank has been active in the past, but which has nothing to do with obligations assumed under the WTO. More fundamentally, the subject matter of the Aid for Trade initiative is drastically different from Part IV discussed earlier. If Part IV was such a good idea, why change course? The simple answer is, it was not.

At present, the WTO has found a place at the table discussing development issues, and not just trade and development. Trade is but a component in this discussion, as it should be. What matters most is to avoid the mistakes of the past. The table should be large enough to fit donors (some WTO members), beneficiaries (some other WTO members), as well as those with technical expertise (the World Bank, the WTO, etc.).

[48] Kyle Bagwell and Robert W. Staiger, *Can the Doha Round Be a Development Round? Setting a Place at the Table* (Mimeo, 2011).

20

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1. Introduction

The 'link' between international trade and protection of the environment requires explanation. In the popular mind, and even amongst some specialists, the topic of the WTO and the environment dominates discussion. One finds criticism such as the following:

> The WTO has been a disaster for the environment. Threats—often by industry but with government support—of WTO-illegality are being used to chill environmental innovation and to undermine multilateral environmental agreements. Already WTO threats and challenges have undermined or threatened to interfere with U.S. Clean Air rules, the U.S. Endangered Species Act, Japan's [sic] Kyoto (global warming) Treaty implementation, a European toxics and recycling law, U.S. longhorned beetle infestation policy, EU ecolabels, U.S. dolphin protection legislation and an EU humane trapping law.
>
> Things only stand to get worse ...[1]

This criticism implies that the link between trade and the environment is one of overlap and opposition. Upon analysis, this is not the case.

First, international trade and protection of the environment are both essential for the welfare of mankind. In the vast majority of cases, these two values do not come into conflict. On the contrary, they are mutually supportive. As stated in Agenda 21, adopted at the UN Conference on Environment and Development in 1992,

> Environment and trade policies should be mutually supportive. An open multilateral trading system makes possible a more efficient allocation and use of resources and thereby contributes to an increase in production and incomes and to lessening demands on the environment. It thus provides additional resources needed for economic growth ... and improved environmental protection. A sound environment, on the other hand, provides the ecological and other resources needed to sustain growth and underpin continuing expansion of trade.[2]

Second, taking active steps to protect the environment is beyond the scope of authority allotted to the WTO under international law. The WTO's function is limited to administering the WTO agreements.[3] Thus, the WTO deals only with trade, not protection of the environment. The WTO agreements apply to measures protecting the environment only where and insofar as they have an impact on international trade. Relatively few environmental measures fall into this category.

Third, nothing in the WTO agreements requires that free trade be accorded priority over environmental protection. Rather, the Preamble to the WTO Agreement acknowledges that expansion of production and trade must allow for 'the optimal use of the world's resources in accordance with the objective of sustainable development, seeking

[1] Lori Wallach and Michelle Sforza, *The WTO: Five Years of Reasons to Resist Corporate Globalization* (New York: Seven Stories Press, 1999) 27.

[2] Agenda 21, § 2.19, UN Doc. A/CONF. 151/4 (1992), reprinted in 31 I.L.M. 881.

[3] WTO Agreement Art. III.

both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development'.[4]

Thus, what is sought is balance between the two objectives of free trade and environmental protection. In addition, the WTO is sensitive to uncovering measures that purport to be for environmental reasons but are, in fact, a subterfuge for serving other interests, such as the protection of domestic producers.

Accordingly, many WTO agreements contain conditional exceptions for environmental measures.

The GATT 1994 states as follows in Article XX:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
>
> ...
>
> (b) necessary to protect human, animal or plant life or health;
>
> ...
>
> (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

The General Agreement on Trade in Services (GATS) contains an identical exception to GATT Article XX(b).[5] The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) states that 'Members may exclude from patentability inventions, the prevention within their territory of the commercial exploitation of which is necessary . . . to protect human, animal or plant life or health or to avoid serious prejudice to the environment'.[6] The Agreement on Subsidies and Countervailing Measures (SCM) contains an exemption for certain environmental subsidies.[7] The Agreement on Technical Barriers to Trade (TBT) states that protection of the environment is a 'legitimate objective' that allows a WTO member to enact high standards of protection.[8] The Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) sets out criteria to supplement GATT Article XX(b) to govern the validity of national measures passed to protect humans, plants, and animals from contaminants, disease-carrying organisms, and pests.

[4] WTO Agreement, 1st recital in the Preamble. The most commonly cited definition of 'sustainable development' is development that meets the needs of the present without compromising the needs of future generations. *World Commission on Environment and Development, Our Common Future* (Oxford: Oxford University Press, 1987) 393. However, although the concept of sustainable development has engendered a large literature, the vagueness of this concept has prevented it from becoming truly operational in legal disputes. See Alison Peck, 'Sustainable Development and the Reconciliation of Opposites' (2012) *St. Louis University L. J.* 57, 151. For example, the Panel in the 2014 *China—Rare Earths* case (paras. 7.261–7.265) ruled that the concept of sustainable development is relevant to interpreting the concept of 'conservation' in GATT Art. XX(g), but this was limited to stating that 'conservation and development are not mutually exclusive goals.'

[5] GATS Art. XIV(b). [6] TRIPs Art. 27.2. [7] SCM Agreement Art. 8.2(c).

[8] SPS Agreement Art. 2.2.

The latter agreements are the subjects of separate chapters in this book and will be discussed only briefly here. This chapter concentrates on GATT Article XX, which has produced the liveliest discussion and the most interesting interpretations.

The WTO established a Committee on Trade and Environment (CTE) in 1995. The CTE was charged with making appropriate recommendations on 'the need for rules to enhance the positive interaction between trade and environment measures for the promotion of sustainable development'. The CTE was asked to address the following matters:

1. 'the relationship between the provisions of the multilateral trading system and trade measures for environmental purposes, including those pursuant to multilateral environmental agreements';
2. 'the relationship between environmental policies relevant to trade and environmental measures with significant trade effects and the provisions of the multilateral trading system';
3. 'the relationship between the provisions of the multilateral trading system and: (a) charges and taxes for environmental purposes[,] (b) requirements for environmental purposes relating to products, including standards and technical regulations, packaging, labelling and recycling';
4. 'the provisions of the multilateral trading system with respect to the transparency of trade measures used for environmental purposes and environmental measures and requirements which have significant trade effects';
5. 'the relationship between the dispute settlement mechanisms in the multilateral trading system and those found in multilateral environmental agreements';
6. 'the effect of environmental measures on market access, especially in relation to developing countries, in particular to the least developed among them, and environmental benefits of removing trade restrictions and distortions';
7. 'the issue of exports of domestically prohibited goods';
8. 'the relevant provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights';
9. 'the work programme envisaged in Decision on Trade in Services and the Environment'; and
10. 'input to the relevant bodies in respect of appropriate arrangements for relations with inter-governmental and non-governmental organizations'.[9]

However, no significant decision has been taken by the CTE, which is open to participation by all members. Consequently, the Final Declaration of the Doha Ministerial Conference in November 2001, adopted a Trade and Environment Work Programme, which includes the following:

1. The relationship between WTO rules and trade restrictions in multilateral environmental agreements;

[9] Decision on Trade and Environment, in WTO, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (Cambridge, UK: Cambridge University Press, 1999) 411.

2. Criteria for granting observer status and information exchange;
3. Reduction and elimination of trade barriers for environmental goods and services; and
4. Fisheries subsidies.[10]

In addition, the CTE was instructed to give particular attention to (1) the effect of environmental measures on market access, especially for developing countries; (2) environmental aspects of TRIPs; and (3) labelling requirements for environmental purposes.

Thus, the accommodation of protection of the environment and trade is yet partial but ongoing.

2. Environmentalist Trade Demands: A Critical Analysis

What is the basis of the environmentalist objection to the rules of the multilateral trading system? Daniel Esty, a distinguished critic, has identified the following four environmentalist critiques:

- Without environmental safeguards, trade may cause environmental harm by promoting economic growth that results in the unsustainable consumption of natural resources and waste production.
- Trade rules and trade liberalization often entail market access agreements that can be used to override environmental regulations unless appropriate environmental protections are built into the structure of the trade system.
- Trade restrictions should be available as leverage to promote worldwide environmental protection, particularly to address global or transboundary environmental problems and to reinforce international environmental agreements.
- Even if the pollution they cause does not spill over into other nations, countries with lax environmental standards have a competitive advantage in the global marketplace and put pressure on countries with high environmental standards to reduce the rigour of their environmental requirements.[11]

3. The Environmental Impact of Trade

Some environmentalist opposition to trade is based on the notion that international mobility of goods, services, and capital is fundamentally anti-environmental. Herman Daly, an economist, for example, has stated that free trade:

> sins against allocative efficiency by making it difficult for nations to internalize external costs; it sins against distributive justice by widening the disparity between labor and capital in high wage countries; it sins against community by demanding

[10] WTO, Ministerial Conference, Fourth Session, Doha, 9–14 November 2001, *Ministerial Declaration*, WT/MIN(01)/DEC/1, 20 November 2001, paras. 31–3.

[11] Daniel C. Esty, *The Greening of the GATT* (Washington DC: Institute for International Economics, 1994) 42.

> more mobility and by further separating ownership and control; [and] it sins against sustainable scale [by offering] a way to loosen local constraints by importing environmental services (including waste absorption) from elsewhere.[12]

The facts, however, belie these charges. It is wrong to blame failure to internalize environmental costs on trade. First, there is little empirical evidence that companies relocate to take advantage of lax pollution controls.[13] Second, countries like Brazil, with very protectionist trade policies, still fail to preserve natural resources. Commercial logging for export, for example, plays little part in the destruction of the Amazon rainforest. Instead, the basic causes are the demand for land and local agriculture and forestry practices.[14]

A 1994 OECD study[15] on the impact of trade on the environment found that the direct effects of trade on the environment are generally small because only a limited share of ecologically sensitive goods enter into trade and because trade is only one of many factors affecting the environment. It found:

> In general, trade is not the root cause of environmental problems, which are due to market and intervention failures. Market failures occur when markets do not reflect environmental values. Intervention failures occur when public policies do not correct for, create or exacerbate market failures. Such failures can distort the incentives for protecting the environment and can drive a wedge between the private and socially optimum rates and modes of production and consumption. Environmental economics has focused on understanding and correcting these failures at the domestic level, but such failures also occur at the international level and increasingly have global impacts. International trade can help correct market and intervention failures through providing increased funds and incentives for environmental protection and promoting efficient resource use. But, at times, international trade may exacerbate the environmental problems in the presence of market and intervention failures.[16]

The impact of trade on the environment is complex; it may be positive, negative, or neutral, depending on the economic sector and the circumstances. The OECD framework for analysis is to consider trade-related environmental impacts from two perspectives (1) market failures and (2) intervention failures. The chief categories of market failure leading to environmental degradation are (1) failure to externalize environmental costs;[17]

[12] Herman E. Daly, 'From Adjustment to Sustainable Development: The Obstacle of Free Trade' (1992) *Loy. L.A. Int'l & Comp. L. Rev.* 15, 33, 41–2.

[13] Judith Dean, 'Trade and Environment: A Survey of the Issues' in Patrick Low, ed., *International Trade and the Environment* (Washington DC: World Bank, 1992) 15, 27.

[14] See Brian F. Chase, 'Tropical Forests and Trade Policy: The Legality of Unilateral Attempts to Promote Sustainable Development under the GATT' (1994) *Hast. Int'l & Comp. L. Rev.* 17, 349, 356–7.

[15] OECD, 'The Environmental Effects of Trade' (1994) (hereinafter: OECD Report).

[16] Ibid. 8.

[17] The OECD Report (at 8) states as follows: 'In other words, the environmental costs are externalities rather than internalised in the prices of goods and services. Environmental externalities stem from the consumption of products which impose costs on others which are not compensated through the market. The divergence of the apparent costs of an activity from its total cost is reflected in the loss of clean air and water and the degradation of environmental resources. Examples are the pollution resulting from excess use of fertilizers and chemicals in the agricultural sector or the pollution associated with intensive aquaculture in the fisheries sector and congestion in the transport sector. Failure to internalise environmental costs at

(2) improper valuation of ecosystems;[18] and (3) ill-defined or open property rights regimes[19] for certain resources. Two categories of intervention failure are (1) subsidies[20] and (2) trade barriers.[21]

the national level can contribute to transboundary and global environmental problems, such as acid rain, river pollution and climate change.'

[18] According to the OECD Report (at 9):

3.1 Improper valuation of ecosystems

Market failures also result from the failure to take into account the total economic value derived by society from the structural features and environmental functions of ecosystems. This total economic value can be categorised into different components, namely direct use value of an environmental asset, which is the most easily quantified, relates to the actual output of goods and services from the asset...

The indirect use value of an environmental asset relates to its functional role in supporting economic activity and may best be measured in terms of the benefits derived from its contribution to the avoidance of environmental damage. For example, forests and wetlands provide both atmospheric and microclimatic support functions, such as carbon retention, flood control and groundwater recharge...

Economists have also identified existence values, relating to the benefits derived from the mere knowledge that an environmental asset exists and plays a functional role in maintaining ecosystems, and option values, associated with the future use of a resource. For example, it is estimated that closed tropical forests hold between 50 and 60 percent of the world's diversity essential to future pharmaceutical and crop-breeding research; this is an option value, part of the total economic value of forests.

[19] The OECD Report (at 9):

Market failures can stem from lack of property rights for environmental assets and the difficulties of defining and enforcing regimes for governing their use. The non-excludable nature of environmental goods, such as air and water, may lead to over-exploitation or over-consumption of a resource due to lack of incentives to protect it against actions that would diminish its supply. For example, the lack of direct ownership of many fisheries resources complicates fisheries management and may contribute to the over-exploitation or depletion of certain world fish stocks. Open access to forested areas in certain regions may contribute to environmentally damaging deforestation.

[20] The OECD Report (at 10):

While most production subsidies are directed to achieving domestic policy goals, they carry implications for both trade and the environment; export subsidies have more direct impacts on trade lows and can also have environmental effects. Distortions caused by production and export subsidies are believed to occur in the *agricultural sector* to a greater extent than in most other sectors. Subsidy policies, which in many countries influence the prices received by farmers and the cost of the inputs they use, can reinforce rather than mitigate market failures. In developed countries, output prices may be supported above market-clearing levels and, in some cases, input prices (for water, fertilizers, etc.).

[21] The OECD Report cited two examples (at 10):

In the fisheries sector, the important tariffs applied to unprocessed products by most developed countries are lower than the tariffs on semi-processed and processed products. For example, the difference in the nominal tariff rates for fresh cod and cod fillets is 10 per cent in some countries, and the effective difference when taking into account weight loss may be nearly 50 per cent. These tariff differentials can contribute to overexploitation and fish stock depletion when exporting countries increase their fresh and frozen fish exports to maximise foreign exchange receipts without implementing proper fisheries management policies.

In the forestry sector, trade protectionism affects resource use and possibly contributes to forest degradation. Developing countries often face lower tariffs on unprocessed wood products and higher relative tariffs on processed products, which could be a factor in unsustainable industrialisation in low income countries. Tariff and quotas on imported forest products may provide protection to domestic forest industries and contribute to unsustainable forestry practices in importing countries.

Using these analytical tools, the positive or negative effects of trade may be identified and measured. With respect to products, trade may make a significant positive contribution by providing the opportunity for the global spread of environmental technologies and services to address particular environmental problems. Traded products may also have a negative environment effect if hazardous wastes or harmful chemicals are involved or through the sale of products from endangered species.

Trade may foster economic efficiency and growth, raising incomes and providing more money for environmental protection. If there is market or intervention failure, however, trade may lead to degradation and depletion of natural resources.

All WTO members should keep the environmental impacts of trade and trade agreements under review.[22] Positive and negative impacts of trade should be identified, the positive impacts enhanced, and the negative aspects eliminated. For example, in the United States, the tariff quota on sugar imports leads to greater production of sugar by American farmers. One of the principal sugar growing areas is in south Florida, where the high water use and fertilizers necessary for the production of sugar cane have an adverse impact on the Everglades, one of the most valuable and productive US ecosystems.[23] Such trade distortions should be removed.

4. The *Tuna Dolphin* Cases: A False Start

Before 1991, the relationship between protection of the environment and international trade was an arcane speciality that attracted little attention.[24] In 1971, the GATT Council established a Working Group on Environmental Measures and International Trade.[25] This group did not even meet for over twenty years.

Everything changed with the decision in the *Tuna Dolphin I* case, in which a GATT Panel declared a US embargo on tuna caught by fishing methods causing high dolphin mortality to be illegal.[26] The *Tuna Dolphin I* decision produced an explosion of rhetoric

[22] In the United States, the basis for doing this exists in the National Environmental Policy Act (NEPA), 42 U.S.C.A. § 4331 *et seq.* Regrettably, the courts have held that negotiating a trade treaty is not 'agency action', which is the trigger for the application of NEPA. See *Public Citizen v US Trade Representative,* 5 F.3d 549 (DC Cir. 1993) (no environmental impact statement required for NAFTA).

[23] For further discussion, see Thomas T. Ankerson and Richard Hamann, 'Ecosystem Management and the Everglades: A Legal and Institutional Analysis' (1996) *J. Land Use & Envtl. L.* 11, 473.

[24] Concern over the issue of trade and environment was expressed by several observers beginning in the early 1970s. See generally William J. Baumol, *Environmental Protection, International Spillovers and Trade* (Stockholm: Almqvist & Wiksell, 1971); C. Fred Bergsten, *The Future of the International Economic Order: An Agenda for Research* (Lexington, MA: Lexington Books, 1973) 42; Wolfgang E. Burhenne and Thomas J. Schoenbaum, 'The European Community and the Management of the Environment' (1973) *Nat. Resources J.* 13, 494 (analysing the problem of harmonizing different environmental standards for products that move in international trade in the context of Community law); Frederic L. Kirgis, Jr, 'Effective Pollution Control in Industrialized Countries: International Economic Disincentives, Policy Response and the GATT' (1972) *Mich. L. Rev.* 70, 859 (analysing legality under the GATT of various environmental taxes on imports).

[25] Decision of the GATT Contracting Parties, GATT Doc. C/M/71 (1971).

[26] *US—Restrictions on Imports of Tuna Dolphin I*, GATT B.I.S.D. (39th Supp.) at 155 (1993), reprinted in 30 I.L.M. 1594 (1991) (unadopted) (hereinafter: *Tuna Dolphin I*).

in both learned journals[27] and the popular press.[28] It was also a very interesting clash of highly different 'cultures': trade specialists versus environmentalists.

Acting under the US Marine Mammal Protection Act (MMPA), the United States had adopted a unilateral ban on imports of yellow fin tuna using methods that also kill dolphins, a protected species under the MMPA. Upon Mexico's complaint to the GATT, a dispute settlement Panel found that the US tuna embargo violated GATT Article XI:1, which forbids measures prohibiting or restricting imports or exports. The United States sought to justify the embargo under GATT Article III:1 and III:4 because US fishermen were subject to the same MMPA rules. The GATT Panel rejected the US argument on the grounds that Article III:1 and Article III:4 permit only regulations relating to products as such. Because the MMPA rules concerned harvesting techniques that could not possibly affect tuna as a product, the ban on tuna could not be justified. This holding was reiterated by a second GATT Panel in the *Tuna Dolphin II* decision, which involved the legality of a secondary embargo of tuna products from countries that processed tuna caught by the offending countries.[29] The *Tuna Dolphin II* Panel condemned the unilateral boycott in even stronger terms.[30]

Both *Tuna Dolphin* Panels also concluded that neither GATT Article XX(b) nor XX (g) could justify the US tuna import ban. As to Article XX(b), both Panels held that the ban failed the 'necessary' test. They rejected the US argument that 'necessary' means 'needed', stating that 'necessary' means that no other reasonable alternative exists and that 'a contracting party is bound to use, among the measures available to it, that which entails the least degree of inconsistency' with the GATT.[31] A trade measure taken to compel other countries to change their environmental policies, and which would be effective only if such changes occurred, could not be considered 'necessary' within the meaning of Article XX(b).[32] Both Panels similarly concluded that Article XX(g) was not applicable; they found that the terms 'relating to' and 'in conjunction with' in Article XX(g) meant 'primarily aimed at', and held that unilateral measures to compel other countries to change conservation policies cannot satisfy the 'primarily aimed at' test.[33]

[27] The literature is too voluminous to cite here. Among the most prolific and vocal commentators have been, on the environmentalist side, Steve Charnovitz, and on the trade side, Jagdish Bhagwati. See especially Steve Charnovitz, 'Free Trade, Fair Trade, Green Trade: Defogging the Debate' (1994) *Cornell Int'l L. J.* 27, 459; Steve Charnovitz, 'A Taxonomy of Environmental Trade Measures' (1993) *Geo. Int'l Envtl. L. Rev.* 6, 1; Jagdish Bhagwati, 'Trade and Environment: The False Conflict?' in D. Zaelke et al., eds., *Trade and the Environment: Law, Economics and Policy* (Washington DC: Island Press, 1993) 159. A leading book on the subject is Esty, *The Greening of the GATT* (1994), n. 11. For a synthesis of the opposing views, see Ernst-Ulrich Petersmann, 'International Trade Law and International Environmental Law: Prevention and Settlement of International Disputes in GATT' (1993) *J. World Trade* 27, 43.

[28] For example, Patricia Dodwell, 'Trade Row Looms over US's Dolphin-Friendly Trade Policy' *Financial Times* (London), 30 January 1992, 22. From time to time, environmental groups have taken full-page ads in national newspapers to oppose the GATT. For example, *Sabotage! New York Times* (nat'l edn.), 20 April 1992, A9.

[29] *US—Restrictions on Imports of Tuna Dolphin II*, DS29/R, 16 June 1994, reprinted in 33 I.L.M. 839 (1994) (unadopted) (hereinafter: *Tuna Dolphin II*).

[30] Ibid. paras. 5.38–5.39.

[31] *Tuna Dolphin I*, para. 5.27; *Tuna Dolphin II*, para. 5.35.

[32] *Tuna Dolphin I*, para. 5.27; *Tuna Dolphin II*, paras. 5.36–5.38.

[33] *Tuna Dolphin I*, para. 5.33; *Tuna Dolphin II*, para. 5.26. The *Tuna Dolphin I* Panel's reasoning was that the US requirement linking maximum incidental kills of dolphins by other countries to US records

The GATT Panels in the two *Tuna Dolphin* cases came to different conclusions regarding the territorial application of Article XX(b) and (g). The *Tuna Dolphin I* Panel concluded that the natural resources and living things protected under these provisions were only those within the territorial jurisdiction of the country concerned.[34] This view, which was based on the belief that the drafters of Article XX had focused on each contracting party's domestic concerns, has been widely criticized.[35] The *Tuna Dolphin II* Panel, in contrast, 'could see no valid reason supporting the conclusion that the provisions of Article XX(g) apply only to . . . the conservation of exhaustible natural resources located within the territory of the contracting party invoking the provision'.[36] Nevertheless, the Panel ruled that governments can enforce an Article XX(g) restriction extraterritorially only against their own nationals and vessels.[37]

5. The WTO Approach under the GATT 1994

These two *Tuna Dolphin* GATT Panel decisions represent the first tentative steps of the multilateral trading system to come to terms with protection of the environment. Neither decision was binding under the GATT because neither was adopted by the contracting parties. Even if they were, they would have little force as precedents because their reasoning was partially inconsistent and because the decisions of prior GATT or WTO Panels are not binding on future Panels.[38] In addition, the WTO Appellate Body is fashioning its own approach to Article XX that makes significantly greater allowance for legitimate measures of environmental protection. Much of the reasoning in the *Tuna Dolphin* cases has been effectively overruled.

and experience was so unpredictable that it would not be primarily related to the conservation of dolphins. Art. XX(g) was held inapplicable in several previous cases for similar reasons. In 1983, a GATT Panel ruled that a US embargo of tuna from Canada could not be justified under Art. XX(g) because there were no US correlative restrictions on the US domestic production or consumption of tuna. (The US had adopted the ban in retaliation against Canada's seizing US fishing vessels.) *US—Prohibition of Imports of Tuna and Tuna Products from Canada*, 22 February 1982, GATT B.I.S.D. (29th Supp.) at 91 (1983).

In *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, 22 March 1988, GATT B.I.S.D. (35th Supp.) 98 (1989) (hereinafter: *Canada Herring*), a Canadian export ban was held illegal since it was found not to be primarily aimed at or relating to conservation or rendering domestic production or consumption restrictions effective. Subsequent to this decision, Canada adopted new regulations requiring salmon and herring caught in Canadian waters to be landed in Canada prior to exportation. A NAFTA dispute Panel declared that this could not be justified under GATT Art. XX(g) since the landing requirement did not 'relate to' the conservation of natural resources. *In re Canada's Landing Requirement for Pacific Coast Salmon and Herring*, CDA-89-1807-01 (US—Canada FTA Ch. 18 decision), 3 Can. Trade & Commodity Tax Cas. (CCH) 7162 (1989).

[34] *Tuna Dolphin I*, paras. 5.26, 5.31.

[35] See, for example, William J. Snape III and Naomi B. Lefkovitz, 'Searching for GATT's Environmental Miranda: Are "Process Standards" Getting "Due Process"?' (1994) *Cornell Int'l L. J.* 27, 777, 782–90; Alison Raina Ferrante, 'The Dolphin/Tuna Controversy and Environmental Issues: Will the World Trade Organization's "Arbitration Court" and the International Court of Justice's Chamber for Environmental Matters Assist the United States in Furthering Environmental Goals?' (1996) *J. Transnat'l L. & Pol'y* 5, 279, 297.

[36] *Tuna Dolphin II*, para. 5.20. [37] Ibid.

[38] Appellate Body report, *Japan—Alcoholic Beverages*, 14.

5.1 GATT Article XX(g)

A consistent theory of interpretation of Article XX(g) has been advanced by the Appellate Body in two important cases, the *US—Reformulated Gasoline* case[39] and the *Shrimp/Turtle*[40] case. The latter case is particularly relevant because it involved a trade measure similar to those employed in the *Tuna Dolphin* cases, a ban on imported shrimp from countries that do not require their fishermen to harvest shrimp with methods that do not pose a threat to sea turtles. The first issue that must be addressed under Article XX(g) is whether the particular trade measure[41] concerns the conservation of exhaustible natural resources.[42] The Appellate Body has taken a generous view of this matter: a 'resource' may be living or non-living, and it need not be rare or endangered to be potentially 'exhaustible'. Thus, dolphins, clean air, gasoline, and sea turtles qualify. Under this expansive interpretation, virtually any living or non-living resource, particularly those addressed by multilateral environmental agreements, would qualify.

The second 'relating to' element of Article XX(g) has proved more difficult to apply. Although a trade measure does not have to be 'necessary' (as in Article XX(b)) to natural resource conservation, the GATT Panels have interpreted 'relating to' to mean that it must be 'primarily aimed at' conservation.[43] Thus phrased, this requirement has proved a difficult obstacle. The question arises whether the 'primarily aimed at' interpretation of 'relating to' is correct. Certainly, these phrases are not synonymous. The 'primarily aimed at' requirement seems to be an unwarranted amendment of Article XX. As the Appellate Body in *US—Reformulated Gasoline* pointed out, 'the phrase "primarily aimed at" is not, itself, treaty language and was not designed as a simple litmus test' for Article XX.[44] Rather the Appellate Body interprets the phrase 'relating to' as meaning there must be a 'close and genuine relationship of ends and means'.[45] 'Conservation' in turn means 'the preservation of the environment, especially of natural resources.'[46]

A third requirement of Article XX(g) is that the measure in question must be 'made effective in conjunction with restrictions on domestic production or consumption'. The Appellate Body in the *US—Reformulated Gasoline* case gave the definitive interpretation of this phrase:

> [T]he basic international law rule of treaty interpretation . . . that the terms of a treaty are to be given their ordinary meaning, in context, so as to effectuate its object and

[39] Appellate Body report, *US—Reformulated Gasoline.*

[40] Appellate Body report, *Shrimp/Turtle.* For discussion of the case, see, for example, Howard Mann, 'Of Revolution and Results: Trade Law and Environmental Law in the Afterglow of the *Shrimp–Turtle* Case' (1998) *Y.B. Int'l Envtl. L.* 9, 28; Thomas J. Schoenbaum, 'The Decision on the *Shrimp–Turtle* Case' (1998) *Y.B. Int'l Envtl. L.* 9, 35; David A. Wirth, 'Some Reflections on Turtles, Tuna, Dolphin and Shrimp' (1998) *Y.B. Int'l Envtl. L.* 9, 40.

[41] The term 'measure' here means the law or rule challenged as inconsistent with WTO/GATT norms. Appellate Body report, *US—Reformulated Gasoline*, 19.

[42] Appellate Body report, *Shrimp/Turtle*, para. 127.

[43] See *Canada Herring,* para. 6.39; Appellate Body report, *US—Reformulated Gasoline*, 19.

[44] Appellate Body report, *US—Reformulated Gasoline*, 19.

[45] Appellate Body report, *China—Raw Materials*, para. 355.

[46] Ibid.

> purpose, is applicable here … [T]he ordinary or natural meaning of "made effective" when used in connection with a measure—a governmental act or regulation—may be seen to refer to such measure being "operative," as "in force," or as having "come into effect." Similarly, the phrase "in conjunction with" may be read quite plainly as "together with" or "jointly with." Taken together, the second clause of Article XX(g) appears to us to refer to governmental measures like the baseline establishment rules being promulgated or brought into effect together with restrictions on domestic production or consumption of natural resources … [W]e believe that the clause "if such measures are made effective in conjunction with restrictions on domestic product[ion] or consumption" is appropriately read as a requirement that the measures concerned impose restrictions, not just in respect of imported gasoline but also with respect to domestic gasoline.[47]

As the Appellate Body further pointed out, however, the 'in conjunction with' element requires a certain amount of even-handedness, but not identity of treatment, and restrictions on either domestic production or consumption will be satisfactory.[48] The 'in conjunction with' requirement is best interpreted, according to the Appellate Body, as meaning simply work 'together, jointly with':[49] 'Article XX(g) thus permits trade measures relating to the conservation of exhaustible natural resources when such trade measures work together with restrictions on domestic production or consumption, which operate so as to conserve an exhaustible natural resource.'[50]

A similar approach was used in the *Shrimp/Turtle* case.[51] The Appellate Body found that the design of the measure or means used in the import ban on shrimp was reasonably related to the end or purpose of protecting sea turtles (just as the Appellate Body in the *US—Reformulated Gasoline* case found that there was a reasonable relationship between the baseline establishment rules and clean air). Moreover, the 'in conjunction with' requirement was satisfied because the United States required all shrimp trawlers to use turtle excluder devices in areas and at times when there is a likelihood of intercepting sea turtles. Thus, there are correlative restrictions on the domestic harvesting of shrimp.[52]

The approach to Article XX(g) now mandated by the Appellate Body is substantially different from the restrictive and somewhat illogical interpretations of GATT Panels, particularly the *Tuna Dolphin* decisions. In fact, the US restrictions on the harvesting of tuna would now pass Article XX(g) with flying colours. Dolphins clearly are an exhaustible natural resource; the import ban on tuna harvested by methods that kill dolphins clearly is related to the purpose of cutting dolphin mortality; and the requirements protecting dolphins also apply to US vessels and fishermen. Importantly also, the Appellate Body in the *Shrimp/Turtle* case gave clear extraterritorial scope to Article XX(g): it applies without distinction to exhaustible resources beyond areas of national jurisdiction as well as to domestic resources.[53]

[47] Appellate Body report, *US—Reformulated Gasoline*, 20.
[48] Ibid. 21.
[49] Appellate Body report, *China—Raw Materials*, para. 356.
[50] Ibid.
[51] Appellate Body report, *Shrimp/Turtle*, paras. 138–42.
[52] Ibid. paras. 143–5.
[53] Ibid. paras. 132–3.

5.2 GATT Article XX(b)

The Appellate Body has fashioned a new approach to consider the GATT-compatibility of health measures 'necessary to protect human, animal or plant life or health' under Article XX(b). The *EC—Asbestos* case[54] involved a Canadian complaint against a French regulation that prohibits the manufacture, sale, and import of all asbestos products, subject to limited exceptions where no substitute product exists. The Appellate Body upheld the ban, and pointed to two separate ways such national health or environmentally protective measures can be approved under the GATT 1994. First, when considering whether the banned product or substance is a 'like product' to permissible products for purposes of applying the national treatment standard of GATT Article III:4, the Appellate Body stated that a crucial factor is evidence that consumers' behaviour is influenced by the health or environmental risks associated with a product.[55] Thus, the fact that a product entails health or environmental risks may justify different treatment from otherwise similar products, and an import ban coupled with a ban on domestic manufacture and sale may satisfy GATT Article III:4.

Second, the Appellate Body in the *EC—Asbestos* case provided a new interpretation of GATT Article XX(b) that provides more flexibility to national governments in enacting measures to protect health and the environment. Article XX(b) has two requirements: (1) a showing that a measure is intended to protect human, animal, or plant life, or health; and (2) proof that the measure is 'necessary'.[56] Under the GATT 1947, the 'necessary' criterion was interpreted very restrictively.[57] In the *EC—Asbestos* case, however, the Appellate Body emphasized the interpretation of 'necessary' as 'reasonably available'.[58] This approach shows deference and gives flexibility to national authorities.

Upholding a French ban on imports of asbestos under Article XX(b), the Appellate Body held that where there is a scientifically proven risk to health, 'WTO members have the right to determine the level of protection of health that they consider appropriate . . . ', based *either* on the quality of the risk (that is, is it regarded as socially acceptable?) or on the quantity of the risk (that is, how likely is it?). The more vital the common interests or values pursued, the easier it would be to accept as 'necessary' measures designed to achieve those ends. In this case, it found that there was no alternative means of eliminating the risk. The Appellate Body's approach to the application of Article XX(b) thus brings it closer to the proportionality or balancing analysis applied by the European Community and the United States[59] when testing the necessity of restrictions on trade for environmental purposes.

[54] Appellate Body report, *EC—Asbestos.*

[55] Ibid. para. 122.

[56] *Tuna Dolphin II*, para. 5.29.

[57] See Thomas J. Schoenbaum, 'International Trade and Protection of the Environment: The Continuing Search for Reconciliation' (1997) *Am. J. Int'l L.* 91, 268, 276–7.

[58] Appellate Body report, *EC—Asbestos*, para. 172. The Appellate Body first developed this newly flexible test for 'necessity' in the case, Appellate Body report, *Korea—Various Measures on Beef*, WT/DS161/AB/R, 10 January 2001.

[59] See Case 302/86, *Commission v Denmark* [1988] E.C.R. 4607 (hereinafter: the *Danish Bottles* case) (applying a proportionality analysis); *Minnesota v Clover Leaf Creamery Co.*, 449 US 456 (1981) (applying a balancing test).

Additional WTO Appellate Body decisions also emphasize the flexibility of the 'necessity' test. In the *US—Gambling* case,[60] which considered the issue in the context of Article XIV of the General Agreement on Trade in Services (GATS), the Appellate Body stated that assessment of necessity involves weighing and balancing the relative importance of the interests or values furthered by the challenged measure, how the measure realizes the ends pursued, and its restrictive effect on commerce. In the *Dominican Republic Cigarettes* case,[61] the Appellate Body emphasized weighing a fourth factor, whether an alternative to the measure is reasonably available. Thus, the Appellate Body has now evolved a consistent method of applying the 'necessity' test.

The Appellate Body had occasion to apply its formulation of the 'necessity' test in the 2007 case of *Brazil—Retreaded Tyres*.[62] That case involved Brazil's import ban on retreaded tyres on the justification that thereby the number of waste tyres in Brazil would be reduced. In analysing the necessity of the ban under GATT Article XX(b) the Appellate Body first applied the standard three factors: (1) an assessment of the relative importance of the interests or values furthered by the ban; (2) the contribution of the ban to the stated goal; and (3) the restrictive impact on international commerce.[63] The Appellate Body agreed with the Panel that the goal of the measure was to reduce the incidence of exposure to risks to animal, plant, and human life arising from the accumulation of waste tyres, and found that the ban would contribute to the achievement of this objective. Importantly, the Appellate Body ruled that the determination whether the measure in question contributes to the objective pursued could be qualitative in nature, and it was accordingly not necessary to conduct a quantitative analysis. The Appellate Body also ruled that the fact that the ban was a total restriction on international commerce was not fatal and could be justified in the light of the strength of the importance of the first two factors.[64] Finally, the Appellate Body examined as part of the balancing process whether there were possible alternatives to the import ban that would achieve the same objective but be less trade restrictive than a total ban. The Appellate Body upheld the analysis of the Panel on this point, finding that suggested alternatives, such as landfilling, waste tyre incineration, and recycling carried their own possible risks or impracticalities.[65]

With respect to the weighing and balancing process involved in applying these factors, the Appellate Body defined this as 'a holistic operation that involves putting all the variables of the equation together and evaluating them in relation to each other after having examined them individually, in order to reach an overall judgment.'[66]

5.3 GATT Article XX(a)

In the *EC—Seal Products* case the Appellate Body approved a new method of justifying environmental trade measures under the GATT: compliance with the general

[60] Appellate Body report, *US— Gambling*, WT/DS285/AB/R, 7 April 2005.

[61] Appellate Body report, *Dominican Republic—Import and Sale of Cigarettes*, WT/DS302/AB/R, 25 April 2005.

[62] WT/DS/332/AB/R, Appellate Body report, 17 December 2009.

[63] Ibid. paras. 139–43. [64] Ibid. paras. 148–9. [65] Ibid. paras. 173–5.

[66] Ibid. para. 182.

exception in GATT Article XX(a) for measures necessary to protect public morals. The *Seal Products* case involved EU Regulation (EC) No. 1007/2009 of 16 September 2009 and its implementing Regulation (EC) No. 737/2010 of 10 August 2010, which prohibit placing seal products on the market in the EU unless certain conditions are satisfied, notably (1) that the seal products come from hunts conducted by Inuit and other indigenous communities and contribute to their subsistence (IC exception); (2) where the seal products result from by-products of hunting authorized by national law for the sole purpose of sustainable management of marine resources (MRM exception); and (3) where the seal products consist of goods for the personal use of travellers and their families (travellers exception).

The Appellate Body, considering the consistency of these regulations with the GATT, after finding that the measures were discriminatory under the tests of GATT Article 1:1 (the Panel had found discrimination violating Article III:4 as well), ruled that GATT Article XX(a) could be employed provisionally to justify such environmental measures. The application of Article XX depends on proof of three elements: (1) that the measure has the objective of protecting public morals; (2) that the measure in fact substantially contributes to this protection; and (3) that the measure is necessary in this regard. In the *Seal Products* case the Appellate Body, in the light of all the evidence presented, including the stated purpose, the text and legislative history, and the design, structure, and operation of the measure, concluded that the objective of the EU Seal Trading Regime fell within the scope of GATT Article XX(a).[67] Furthermore the Appellate Body found that the EU measure makes a material contribution to this objective, considering both the permissive and the prohibitive elements of the regime.[68]

On the 'necessary' issue, the Appellate Body focused on whether an alternative less GATT-restrictive measure was reasonably available. The Appellate Body considered several alternatives in this regard, such as a certification of humane taking requirement and a labelling requirement and concluded that these presented difficulties both as to their contribution to the objective and their reasonable availability.[69]

Thus, the Appellate Body concluded that the requirements of Article XX(a) were provisionally met; however, examining the provisions of the chapeau of Article XX, the Appellate Body found arbitrary and unjustifiable discrimination. In this regard, it found discrimination in the treatment of seals from hunting by Inuit communities in Greenland and in Canada. Although the same conditions prevailed with respect to these indigenous communities the EU Seal Trading Regime treated them differently, considering seal products from Greenland to be admissible while generally excluding seal products generated by Inuit communities in Canada on the ground that the hunts in question were commercial in nature. Thus the IC exception was applied discriminatorily by the EU and inconsistently with the chapeau of Article XX.

[67] Appellate Body report, *EC—Seal Products*, para. 5.201.
[68] Ibid. para. 5.228. [69] Ibid. paras. 5.274–5.277.

5.4 The chapeau of GATT Article XX

All of the Article XX exceptions are qualified by the chapeau, which sets out the tests for the manner in which a trade measure is applied. Three standards are stated in the chapeau: (1) arbitrary discrimination; (2) unjustifiable discrimination; and (3) a disguised restriction on international trade. In the *Shrimp/Turtle* case, the Appellate Body stated that the chapeau is (1) a balancing principle to mediate between the right of a member to invoke an Article XX derogation and its obligation to respect the rights of other members; (2) a qualification making the Article XX exemptions 'limited and conditional';[70] (3) an expression of the principle of good faith in international law; and (4) a safeguard against *abus de droit*, the doctrine that requires the assertion of a right under a treaty to be 'exercised bona fide, that is to say reasonably'.[71] According to the Appellate Body, the chapeau protects 'both substantive and procedural requirements'.[72]

In the *Shrimp/Turtle* case, the unilateral measures applied by the United States to protect sea turtles were found to violate the chapeau's criteria against arbitrary and unjustifiable discrimination. The Appellate Body's reasoning focused on the manner of application of the US regulations. First, it found that there was 'arbitrary discrimination' because US law required a 'rigid and unbending . . . comprehensive' regulatory programme that is essentially the same as the US programme, without inquiring into the appropriateness of that programme for the conditions, prevailing in the exporting countries.[73] Arbitrary discrimination was found to exist separately because the US authorities, in their certification process for shrimp imports, did not comply with basic standards of fairness and due process with regard to notice, the gathering of evidence, and the opportunity to be heard. The Appellate Body found that the GATT requires 'rigorous compliance with the fundamental requirements of due process' with respect to obligations.[74]

Second, the US regulations were 'unjustifiable'[75] because they required (1) a duplication of the US programme without considering conditions in other countries; and (2) applied differing phase-in periods for countries similarly situated and impacted by the import ban. Most importantly, the Appellate Body held that it was unjustifiable discrimination for the United States not to have negotiated seriously with some of the affected countries: the subject matter—protection of sea turtles—demanded international cooperation, the US statute recognized the importance of seeking international agreements, and the United States had, subsequent to imposing its own restrictions, entered into the 1996 Inter-American Convention for the Protection and Conservation of Sea Turtles. The Appellate Body concluded: 'The Inter-American Convention thus provides convincing demonstration that an alternative course of action was reasonably open to the USA'.[76]

In response to the Appellate Body's decision in the *Shrimp/Turtle* case, the United States retained the ban on shrimp from countries that do not protect sea turtles, but substantially revised its regulations to allow imports of shrimp harvested under

[70] Appellate Body report, *Shrimp/Turtle*, para. 157. [71] Ibid. para. 158.
[72] Ibid. para. 160. [73] Ibid. para. 177. [74] Ibid. para. 182.
[75] Ibid. [76] Ibid. para. 171.

specified conditions in which sea turtles are not harmed. The United States also entered into negotiations with the countries adversely affected and offered them technical assistance in conserving sea turtles. In 2001, the Appellate Body ruled that these US measures satisfied the conditions of the chapeau.[77] It ruled that the US regulatory scheme no longer was discriminatory. First, putting in place a regulatory programme that is comparable in effectiveness to the domestic programme 'gives sufficient latitude to the exporting Member'.[78] Second, the Appellate Body rejected the argument that the chapeau requires the conclusion of an international agreement on the conservation and protection of sea turtles. Rather, 'serious, good faith efforts' to negotiate an agreement are sufficient to satisfy the chapeau.[79]

Taken together, the *Shrimp/Turtle* case and the *EC—Asbestos* case have overturned the *Tuna Dolphin* decisions' reasoning and transformed GATT 1994 Article XX into an adequate tool for a balanced approach to the trade and environment controversy.[80]

The chapeau also played an important role in the *Brazil—Retreaded Tyres* case,[81] which involved an import ban on retreaded tyres enacted for the purpose of reducing the amount of waste tyres in Brazil and thereby the health risks to humans and the environment. Although the import ban passed the necessity test of GATT Article XX (b),[82] imports of used tyres through court injunctions and exemptions for free trade agreement partners constituted arbitrary and unjustifiable discrimination and a disguised restriction on international trade.[83]

6. Multilateral and Bilateral Environmental Agreements

A question of paramount importance is how the WTO/GATT system will accommodate multilateral environmental agreements (MEAs) which employ trade restrictions.[84] Leading examples of such MEAs include the Montreal Protocol on Substances that Deplete the Ozone Layer,[85] which adopts trade controls that are more restrictive as to non-parties than parties; the Convention on International Trade in Endangered Species (CITES),[86] which regulates imports and exports in certain species of animals and plants and allows punitive trade restrictions to be imposed on non-complying parties; and the Basel Convention on the Control of Transboundary Movements of Hazardous

[77] WT/DS58/AB/RW, 21 November 2001. [78] Paras. 122 and 144.

[79] Para. 134.

[80] But see Sanford Gaines, 'The WTO's Reading of the GATT Article XX Chapeau: A Disguised Restriction on Environmental Measures' (2001) 22 *U. Pa. J. Int'l Econ. L.* 739, 743–5.

[81] WT/DS332/AB/R, Appellate Body report, 17 December 2009.

[82] See the analysis in the preceding section.

[83] *Brazil—Tyres*, Report of the Appellate Body, paras. 246, 247, and 251.

[84] See James Cameron and Ian Robinson, 'The Use of Trade Provisions in International Environmental Agreements and Their Compatibility with the GATT' (1991) *Y.B. Int'l Envtl. L.* 2, 3; Richard G. Tarasofsky, 'Ensuring Compatibility between Multilateral Environmental Agreements and the GATT/WTO' (1996) *Y.B. Int'l Envtl. L.* 7, 52; Duncan Brack, 'The Shrimp-Turtle Case: Implications for the Multilateral Environmental Agreement' (1998) *Y.B. Int'l Envtl. L.* 9, 13.

[85] Montreal Protocol on Substances that Deplete the Ozone Layer, 16 September 1987, 26 I.L.M. 1550 (1987), amended by 30 I.L.M. 539 (1991).

[86] Convention on International Trade in Endangered Species of Wild Fauna and Flora, 3 March 1973, 993 U.N.T.S. 243, 22 June 1979 and 30 April 1983, available at <http://www.cites.org/eng/disc/text.shtml> (hereinafter: CITES).

Wastes,[87] which prohibits exports and imports of hazardous and other wastes by parties to the Convention to and from non-party states.

Trade measures in MEAs make take a variety of forms. For example, (1) reporting requirements on the extent of trade in particular products; (2) labelling or other identification requirements; (3) requirements for special consent procedures in connection with exporting or importing; (4) restrictions or bans on exporting or importing; (6) taxes, charges, or other fiscal measures; (7) non-fiscal measures such as government procurement prohibitions; or (8) discriminatory treatment either as an incentive to comply or as punishment for non-compliance with an environmental regime.

As a general matter, both the WTO Committee on Trade and Environment and the Appellate Body favour MEAs. The CTE has endorsed 'multilateral solutions based on international cooperation and consensus as the best and most effective way for governments to tackle environmental problems of a transboundary or global nature'.[88] The GATT Panel in the *Tuna Dolphin I* case stated that dolphins could be protected through 'international cooperative arrangements'.[89] The WTO dispute settlement Panel and the Appellate Body in the *Shrimp/Turtle* case strongly favoured MEAs as well.[90] However, it is difficult to predict how a WTO Panel would rule on particular MEAs. Thus, there is an urgent need to clarify their legal status.

The WTO could address the relationship between GATT and multilateral environmental agreements in one of four ways. First, each MEA could be examined on a case-by-case basis using Article IX:3 of the WTO Agreement. This provision allows waiver of any obligation under 'exceptional circumstances' by vote of a three-fourths majority of the member states. For several reasons, this solution seems unsatisfactory. The WTO would abdicate from setting criteria to influence MEAs and, thus, states would have no prior guidance when framing them. Moreover, the test of 'exceptional circumstances' is unduly vague. Approval under the waiver provision would be a political decision rather than one on the substance of the case. Furthermore, the status of MEAs would be doubtful until they had received the *ex post* blessing of a waiver.

A second possible solution is to follow the approach of the North American Free Trade Agreement (NAFTA), which provides that certain MEAs (such as the Montreal Protocol, CITES, and the Basel Convention) take precedence over NAFTA obligations.[91] This clarifies the status of certain MEAs but does not provide a process for the approval of future MEAs. Furthermore, an ad hoc approach such as this may be workable for an organization of three states, but may not be for the WTO.

[87] Basel Convention on the Control of Transboundary Movements of Hazardous Wastes, 22 March 1989, UN Doc. EP/IG.80/3 (1989), reprinted in 28 I.L.M. 649 (1989).

[88] WTO, Committee on Trade and Environment, Report (1996) of the Committee on Trade and Environment, WT/CTE/1, 12 November 1996, para. 171 (hereinafter: 1996 CTE Report).

[89] *Tuna Dolphin I*, para. 5.28.

[90] Panel report, *US—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/R (1998), para. 50; Appellate Body report, *Shrimp/Turtle*, paras. 68–9.

[91] North American Free Trade Agreement, 17 December 1992, 32 I.L.M. 289, 296, and 605 (hereinafter: NAFTA).

Two additional alternatives are to amend Article XX by adding a provision on MEAs or to adopt an interpretation[92] of Article XX that would validate existing MEAs and provide for notification of future MEAs as well as set out criteria, a 'safe harbour', they would have to fulfil to receive approval.[93] A model for MEAs might be GATT Article XX(h), which creates an exception for trade measures imposed pursuant to obligations in international commodity agreements that otherwise are illegal under the GATT. Article XX(h) sets out two methods of approval. First, commodity agreements that conform to specified criteria are valued automatically. Second, other commodity agreements can be evaluated on an ad hoc basis if they are submitted to the GATT contracting parties and not disapproved. Robert E. Hudec advocates a similar GATT amendment for MEAs.[94] Such an amendment[95] might provide that (1) negotiation of the MEA shall be under the auspices of the United Nations Environment Programme (UNEP) or a similar organization, and accession shall be open to all states that have a legitimate interest in the environmental problem addressed; (2) the problem dealt with must relate to serious environmental harm; (3) there must be a reasonable relationship between the trade restrictions adopted and the object and purposes of the MEA; and (4) the MEA must be formally notified to the WTO. This would effectively immunize current and future MEAs from attack under WTO/GATT rules.

Finally, there is a way to validate MEAs without resorting to waiver or a GATT amendment. Article 31.3 of the Vienna Convention on the Law of Treaties (VCLT) requires that, in the interpretation of any treaty, there shall be 'taken into account' (a) any subsequent agreement between the parties; (b) any subsequent practice; and (c) any relevant rules of international law. This provision brings MEAs into the WTO/GATT legal system.

7. Unilateral Measures

The *Shrimp/Turtle* case is a well-reasoned decision of great importance for the trade and environment controversy. The Appellate Body, unlike prior GATT Panels, did not totally condemn unilateral action or declare it illegal per se. The Appellate Body stated only that '[T]he unilateral character ... heightens the disruptive and discriminatory influence of the import prohibition and underscores its unjustifiability'.[96] This leaves room for unilateral measures to protect the environment beyond national jurisdiction. If, for example, the US measures in the *Shrimp/Turtle* case had been tailored carefully to meet due process concerns, were suited to conditions in other countries, and especially if the countries concerned had spurned offers of negotiation or refused to negotiate in good faith, it is probable that unilateral measures to protect turtles would

[92] An interpretation can be adopted by a three-quarters majority vote of the WTO Ministerial Conference. WTO Agreement Art. IX:2.

[93] These ideas are discussed in Vinod Rege, 'GATT Law and Environment-Related Issues Affecting the Trade of Developing Countries' (1994) *J. World Trade* 28(3), 95, 124–8.

[94] Ibid. 125–45.

[95] A similar proposal was put forward by the European Union. See 1996 CTE Report, n. 88 at 5–6.

[96] Para. 172.

have been upheld. Of particular interest is the Appellate Body's emphasis on good faith as a principle of international law. If, in a given case, a state were to spurn environmental controls and refuse to enter into negotiations over the depletion of resources beyond national jurisdiction, it would be in breach of the principle of good faith, and unilateral measures may be justified.

8. Energy

Under WTO law energy and energy products do not enjoy any special status; there is no special WTO regime governing energy trade. Since the rules of the WTO and the GATT apply to all forms of trade, they also apply to trade in energy goods and services. Energy raw materials, such as supplies of fossil fuels and uranium, energy-related equipment, energy services, such as electricity, and energy technology, are all widely traded internationally and are thus subject to the rules of international trade.

Although there is no special energy agreement within the WTO, an international agreement that bears upon energy trade was concluded in 1994: the Energy Charter Treaty (ECT), which has fifty-two parties or signatories and aims to provide a framework for international cooperation in the field of energy. The ECT addresses five broad areas of cooperation: (1) protection and promotion of foreign energy investment; (2) free trade in energy materials, products, and energy-related equipment; (3) freedom of energy transit through pipelines and grids; (4) energy efficiency; and (5) dispute resolution. As far as trade is concerned, the original ECT contained Annexes[97] stating non-application of certain WTO rules, including the TRIMs Agreement and many GATT provisions. But in 1998, the parties adopted an Amendment to the Trade-Related Provisions of the ETC, which largely restored GATT and WTO obligations.[98]

Energy-related trade now has a great impact on the environment and this impact will no doubt increase. Special features of the energy sector give rise to important questions under international trade law. Most of these questions have not been litigated at the WTO or in other legal fora. In this section we consider three major distortions of international energy trade: export restrictions; subsidies; and import barriers. In section 15 of this chapter we take up the question of the relationship between trade and international efforts to counteract climate change.

8.1 Export restrictions

Export restrictions on energy-related raw materials may be of two general types: (1) explicit export bans or limitations in the form of export duties, quotas, licensing requirements, or minimum price requirements; and (2) indirect export limitations in the form of production controls.

[97] Energy Charter Treaty, Annexes TRM and G, available at <http://www.encharter.org>.

[98] See Amendment and Guide to the Amendment to the Trade-Related Provisions of the Energy Charter Treaty, <http://www.encharter.org>.

As to export bans or limitations, two cases (analysed later in the chapter)—*China—Raw Materials* and *China—Rare Earths*—ruled that, although export duties[99] are permissible under GATT Article XI:1, export quotas, licensing that has a limiting or restrictive effect, and minimum export price requirements are prohibited under Article XI:1. Thus, such export controls are inconsistent with the GATT unless they meet the stringent tests of the exceptions: GATT Article XI:2 and Article XX(b) and (g). In both *China—Raw Materials* and *China—Rare Earths* the export limitations at issue could not meet these tests. These rulings throw into question many existing export restraints involving energy resources. For example, the United States currently subjects exports of both crude oil[100] and natural gas[101] to permitting and licensing requirements designed to ban most such exports. These provisions appear to be inconsistent with US obligations under the GATT.[102]

A second type of export controls stems from production controls maintained by members of the Organization of Petroleum Exporting Countries (OPEC), which consists of twelve members, most of which are also members of the WTO. Such production controls may be inconsistent with GATT obligations and not protected under United Nations General Assembly Resolutions recognizing state sovereignty over natural resources.[103] In *China—Raw Materials* the Appellate Body ruled that China had agreed to exercise its sovereign rights in a manner consistent with WTO obligations.[104] GATT Article XI:1 forbids all manner of export restraints,[105] not merely direct export controls; thus even crude oil production limitations may be challengeable at the WTO.[106]

8.2 Subsidies

Energy benefits from massive subsidies by governments all over the world. All consumers of energy—whether rich or poor—pay much less than the market economic price for energy. Subsidies are expensive for governments to maintain and they encourage excessive energy consumption. In March 2014, the IMF calculated that total global energy subsidies amount to $1.948 trillion per year.[107] A 2012 OECD inventory of government support for fossil-fuel production or use in member countries turned up over 550 measures with an overall value of $90 billion annually.[108] In 2009, the Group of 20 Advanced and Emerging Market Economies called for a phase-out of

[99] In both cases, however, the export duties in question were ruled inconsistent with China's Accession Protocol, to which the Art. XX exceptions are not applicable.

[100] 15 C.F.R. §§ 754.2–754.3.

[101] 15 U.S.C. § 717b.

[102] US law sanctions imports and exports of energy materials to NAFTA and other countries with which the United States has a free trade agreement. See, for example, NAFTA chapter 6.

[103] GA Resolutions 626 and 1803.

[104] Panel report, para. 7.157.

[105] *Japan—Trade in Semiconductors* (1988).

[106] See Paolo D. Farah and Elena Cima, 'Energy Trade and the WTO: Implications for Renewable Energy and the OPEC Cartel' (2013) *J. Int'l Econ. L.* 16, 707, 735.

[107] See <http://www.imf.org/subsidies>.

[108] See <http://www.oecd.org/BetterPoliciesforBetterLives>.

inefficient fossil fuel subsidies in all countries; this was reaffirmed in 2012, but little has been done.[109]

Since most of the energy subsidies are non-specific, they are generally not attackable under WTO law, which regulates export subsidies and specific non-export subsidies under the Subsidies and Countervailing Measures Agreement. Yet these subsidies severely distort energy production, consumption, and energy trade.

In certain cases of specific energy subsidies, countries have taken actions under the SCM Agreement. For example, both the EU and the United States have levied antidumping and countervailing duties on solar panels made in China that benefit from subsidies that are specific under WTO law. These actions led to a Chinese retaliatory reaction in the form of antidumping tariffs as high as 63.5 per cent on polysilicon, a raw material for solar cells.[110] The EU in response negotiated an agreement with China in December 2014 that sets a minimum price and a volume limit on EU imports of Chinese solar panels. The United States is reportedly seeking a similar agreement from China.[111] In 2011, China ended subsidies for wind power equipment as a result of a US challenge at the WTO.[112] Yet the United States subsidizes wind power heavily through a wind production tax credit that devotes more than $1 billion each year to support wind power projects, rewarding them for every kilowatt-hour of energy they generate (not for providing electricity inexpensively or devising cheaper ways to operate).

These trade disputes over renewable energy and green technology subsidies make little sense. Under the SCM Agreement, any form of export subsidy is prohibited and domestic subsidies for renewable energy or green technology are actionable if a WTO member country believes that its domestic production or exports are adversely affected. Until 2000, the SCM Agreement contained an exemption for certain environmental subsidies, but this exemption was allowed to expire. Thus, under current WTO law, renewable energy subsidies and green technology subsidies are actionable. We think that the WTO should reinstate a carefully crafted exemption for renewable energy and green technology subsidies.

Some so-called renewable energy subsidies, however, are in reality harmful to the environment and should be eliminated. The most outstanding example of a subsidy programme gone wrong is the decades-long subsidy for biofuels in many countries, including the United States, the EU, and in certain developing countries, such as Brazil and India. Biofuels are produced from agricultural crops traditionally used for food or animal feed. There are two main categories of biofuels: ethanol and biodiesel. Ethanol is presently produced from corn and sugar cane, while biodiesel is made from soybeans and rapeseed. A second generation of biofuels is being developed to make use of energy-specific cellulosic crops that can be grown on marginal lands.

[109] <http://www.imf.org/subsidies>.

[110] See <http://www.ustr.gov>.

[111] Bloomberg, EU Nations Approve Pact with China on Solar Panel Imports, <http://www.bloomberg.com/news>.

[112] See <http://www.ustr.gov>.

In many countries biofuels benefit from virtually every conceivable manner of government support and subsidy.[113] In the United States, for example,[114] biofuels benefit from scores of separate tax breaks, subsidies handed out by the US Department of Agriculture and the US Department of Energy, infrastructure subsidies, an import tariff, and a federal production mandate called the Renewable Fuel Standard. For the past thirty years the US Congress has thus nurtured the biofuels industry with tax advantages, producer subsidies, relaxed air pollution emission standards, tariff protection from foreign competition, and a government mandate for biofuel use. As a result, US production of biofuels has soared and the United States has been the largest exporter of biofuels since 2011.[115]

A succession of US administrations have vigorously supported subsidies for biofuels on the grounds that they enhance the US drive toward energy independence and as renewable fuels their use cuts down emissions from fossil fuels that contribute to pollution and to climate change. But these advantages are belied by recent findings confirming disadvantages and environmental impacts of biofuel use. First, many studies confirm that widespread use of biofuels contributes to soaring food prices that hurt developing countries and endanger food security in many countries.[116] Second, the use of biofuels decreases fuel economy. Third, ethanol corrodes pipelines, storage tanks, and engines more severely than gasoline. Fourth, biofuel production diverts land from other uses and this land use impact endangers rainforests in Brazil and other developing countries. Fifth, biofuels may reduce CO_2 emissions (the amount is debated because the so-called reduction does not count the CO_2 emissions during production of biofuels), but their production increases emissions of volatile organic compounds and nitrogen oxides. A 2009 study published in the *Proceedings of the National Academy of Sciences* concluded that the combined health and climate-change costs of biofuels greatly exceeds comparable costs of gasoline use.[117]

Complicating reform of WTO rules involving energy subsidies is the dual international legal regime governing biofuel subsidies. While ethanol and biodiesel are industrial products whose subsidization is governed by the SCM Agreement, both types of biofuel are made from agricultural commodities whose subsidization is governed by the WTO Agreement on Agriculture (AoA). These two international trade regimes have very different purposes and standards. The AoA subsidy regime was never intended to serve as a guide to energy subsidies such as those for ethanol. The criteria of the AoA are unsuited to disciplining ethanol subsidies.

[113] See Global Agricultural Information Network, Brazil, Biofuels Annual (BR 1006, 2010).

[114] For a summary of these provisions, see generally Taxpayer Supports for Corn Ethanol in Federal Legislation, Taxpayers for Common Sense (April 2014).

[115] US Department of Agriculture International Trade Report, 20 July 2011.

[116] See, for example, Agricultural and Resource Economics Update, Giannini Foundation of Agricultural Economics, University of California, (September/October 2008) 12(1); Sanderine Nonhebel, 'Global Food Supply and the Impacts of Increased Use of Biofuels' (2012) *Energy* 37, 115.

[117] Polasky J. Hill et al., 'Climate Change and Health Costs of Air Emissions from Biofuels and Gasoline' *Proceedings of the National Academy of Sciences of the United States of America* (2009) 106, 2077–82. See also Matthew Cimitile, 'Corn Ethanol Will Not Cut Greenhouse Gas Emissions' (2009) *Scientific American* 37.

As the foregoing demonstrates, we submit that energy subsidization constitutes a special matter whose reform is not possible within the contours of current WTO law. We believe the WTO members should negotiate a special framework agreement on energy subsidization that deals with the particular and unique problems of energy production and includes energy services as well.

8.3 The *Canada—Renewable Energy* cases

Japan and the EU complained against Canada at the WTO concerning the policy and pricing structure of the electricity generating system of the province of Ontario, Canada. The Ontario electrical system, overseen by the Ontario Power Authority (OPA) is a complex hybrid arrangement whereby both public and private entities participate in the generation, distribution, and sale of electricity. The price of electricity is closely regulated by the OPA through a so-called Independent Electricity System Operator (IESO) that monitors the system, forecasting supply and demand every five minutes and collecting best offers for the generation of the needed electricity, the so-called market clearing price. Thus, prices for electricity vary greatly over time and are based on the costs of generation. In addition, certain generators are paid congestion management credits and certain generators have contracted prices and receive so-called global adjustments; retail electricity prices are set by the OPA depending on all these arrangements at a small additional charge that guarantees a profit to the system.

The OPA accommodates renewable energy generators—wind, photovoltaic solar, renewable biomass, biogas, landfill gas, and waterpower—through special feed-in tariffs (FITs), which are guaranteed minimum prices per kWh of electricity delivered into the Ontario electric system under twenty- or forty-year contracts with the OPA. Upon entering into a contract with the OPA, such generators are required to build and maintain renewable generating facilities according to OPA-set standards. In the development and construction of such facilities, owners are required to satisfy a minimum domestic content level—their facilities must be composed of required levels of Canadian-purchased goods and services.

The WTO Panel and Appellate Body agreed (for the most part) that the local content requirements under this arrangement were inconsistent with Canada's obligations under the TRIMs Agreement. Canada's domestic content requirements are trade-related investment measures within the scope of Article 2.1 of the TRIMs Agreement, which prohibits certain TRIMs contained in an Illustrative List annexed to Article 2.2 of the Agreement.[118] The prohibited TRIM could not be justified under GATT Article III:8, which exempts government procurement requirements because here what is being purchased is equipment and the purchases are not made by government but by private companies.[119] The TRIMs violation was therefore straightforward and without question.

The controversial aspect of this case concerned the subsidy issue: whether this kind of government intervention in the market for electricity to promote renewable energy

[118] The prohibited TRIM in this case was caught under para. 1(a) of the Illustrative List.
[119] Appellate Body report, para. 5.78.

generation runs afoul of the SCM Agreement. The majority of the Panel in this case ruled that, since the entire market for electricity generation, distribution, and sale is rife with governmental regulation, and because government intervention is necessary to secure an electricity supply that is safe, reliable, and sustainable in the long run, there is a valid benchmark against which a market comparison can be made. Thus, it is impossible to find a 'benefit' which is a necessary finding under the SCM Agreement to find the existence of an actionable subsidy.[120] A dissenting member of the Panel as well as the Appellate Body disagreed with this ruling.[121] The Appellate Body ruled that a valid comparison can and should be made: the FIT should be compared with other relevant markets for solar and wind power generation. But the Appellate Body ruled that it could not make this comparison because the record in the case lacked sufficient facts. Thus the Appellate Body could not rule on the benefit issue.[122]

The exact ramifications of the *Canada—Renewable Energy* cases are unclear, but the Appellate Body did confirm that, in principle, government support for renewable energy may constitute an actionable subsidy that is inconsistent with the SCM Agreement. This ruling thus enhances the case for the negotiation by WTO members of an exemption for certain types of green subsidies that benefit the environment.

8.4 Import tariffs and restrictions

Importing nations levy high tariffs and tax certain energy inputs heavily. Global trade in energy-related goods and services is over $2trillion annually. While some of this trade is raw materials such as oil and coal, a growing portion of this trade is environmentally friendly goods, such as wind turbines, solar panels, and wastewater treatment technology. We are in favour of a WTO plurilateral agreement to abolish tariffs in green goods and green technology. In January 2014, negotiations on such an agreement began under the auspices of the WTO between major trade powers, including the United States, the EU, China, Japan, and some ten additional countries.

9. Protection of Natural Resources

May a WTO member ban or restrict imports or exports of natural resource products on the grounds that this is necessary for conservation or environmental reasons? Natural resources export bans may infringe GATT Article XI:1; in this case such a measure would have to qualify either under GATT Article XI:2(a), which permits an export prohibition or restriction to relieve temporary domestic 'critical shortages', or under Article XX (b), as a measure to safeguard life or health, or XX(g), as a measure related to conservation of exhaustible natural resources. Import bans or restrictions may violate several GATT provisions and may need justification as Article XX general exceptions as well.[123]

[120] Panel report, paras. 7.283–7.320. [121] Panel report, para. 9.23.
[122] Appellate Body report, paras. 5.219–5.246.
[123] See generally Mitsuo Matsushita, 'Export Control of Natural Resources: WTO Panel Ruling on the Chinese Export Restrictions of Natural Resources' (2011) *Trade Law & Development* 3(2), 267.

9.1 Raw materials and minerals

Industrial production depends upon access to raw materials and trade in raw materials is important and essential. On the export side, states limit exports for a variety of reasons, both economic and environmental.[124] Of the variety of ways export controls can be applied—taxes, bans, licensing, quotas, price requirements, and administrative regulations—only export taxes are explicitly permitted under GATT Article XI:1. An export tax, therefore, will pass WTO muster unless such a tax is prohibited under a related agreement, such as a WTO accession agreement[125] or a relevant free trade agreement. Moreover, such export taxes must be non-discriminatory and transparent as required by GATT Articles I and X; and export taxes, like import taxes, may be bound under GATT Article II. Clearly, however, a WTO member desiring to protect raw materials and natural resources for environmental purposes is best advised to employ export taxes for this purpose.

A WTO member that employs a form of export control other than taxes—a ban, quota, or administrative restraint—will run afoul of GATT Article XI:1[126] and the member must look to GATT exceptions for justification. The jurisprudence of the WTO makes clear that the rules surrounding these exceptions are difficult to meet. Three exceptions may be relevant.

First, GATT Article XI:2(a) allows export prohibitions or restrictions temporarily applied to relieve critical shortages of natural resources. As construed by the Appellate Body in the *China—Raw Materials* case, the four requirements of Article XI:2(a) will be strictly applied. First, the WTO member must demonstrate that the export controls are temporary and set in order to supply only a passing need; second, there must be a general or local critical short supply; third, the measure employed must be used to prevent or relieve the shortage in question; and fourth, the natural resource must be 'essential' to the exporting member.[127]

The conservation exception of GATT Article XX (g) may also be used to restrict exports of natural resources. To meet the conservation exception, however, the WTO member must show that the export restriction (1) relates to conservation of an exhaustible natural resource and (2) is made effective in conjunction with restrictions on domestic production or consumption. These requirements are also strictly construed and applied. The conservation measure must bear a 'substantial and close relationship to the conservation objective',[128] and the restriction on domestic production or consumption must have a real limiting effect—'more than just a restriction on the books'.[129] The *China—Raw Materials* and *China—Rare Earths* Panels both emphasized that the conservation measure employed must meet an 'even-handed' requirement in the sense that

[124] Stormy-Annika Mildner and Gina Lauster, 'Settling Trade Disputes over Natural Resources' (2011) *Goettingen Journal of International Law* 3(1), 255, 262. The WTO keeps track of export restraints of members through the trade policy reviews. See WTO, World Trade Report, Trade in Natural Resources (2010).

[125] See *China—Raw Materials*; *China—Rare Earths*.

[126] See *Canada—Unprocessed Herring and Salmon* (GATT Panel); *Argentina—Hides and Leather*; *China—Raw Materials*; and *China—Rare Earths*.

[127] Appellate Body report, *China—Raw Materials*, paras. 323–37.

[128] Panel report, *China—Rare Earths*, paras. 7.279–7.293.

[129] Ibid. paras. 7.305–7.313.

some of the impact of the conservation measure must clearly fall on domestic production or consumption.[130] In both cases the measures in question were deemed to fail the 'evenhandedness' requirement in that they fell disproportionately upon foreign interests.[131]

A third exception may be relevant to permit measures to conserve natural resources: GATT Article XX(b), which requires the member to show that the measures in question are necessary to protect health. An export restriction must meet a balancing test to determine whether the 'necessary' requirement is met. In the *China—Raw Materials* case, the Panel considered three separate elements: (1) the importance of the interests and values at issue; (2) the contribution of the measures to the achievement of their objective; and (3) the trade restrictiveness of the particular measures employed. If analysis of these three factors establishes a preliminary judgment that the measures are necessary, the Panel will consider if this judgment is confirmed by comparing the challenged measures to possible available less trade-restrictive alternatives.[132] In the *China—Raw Materials* case the Panel, applying these criteria, ruled that there was no evidence that the measures in question made a material contribution to reducing pollution and further stated that numerous, less trade-restrictive alternatives were available to safeguard the health of the Chinese people against pollution. Thus, the Panel in *China—Raw Materials* ruled that the measures could not be justified under Article XX(b).

In order to meet the tests under GATT Article XX(b) and (g) a member must also meet the separate requirements imposed by the chapeau of Article XX. In the *China—Rare Earths* case the Panel also found that China did not demonstrate that its conservation measures were non-discriminatory towards foreign interests and not disguised restrictions on international trade.[133]

On the import side, a trade measure other than a tariff to block imports of raw materials or natural resources will similarly be tested under the stringent criteria of Article XX(g), including the chapeau of Article XX.

In summary, WTO jurisprudence thus demonstrates that a member desiring to adopt export or import conservation measures to preserve raw materials or natural resources will have to meet strict legal tests unless export taxes are employed. Either taxes or compliance with GATT Article XX(g) is the best method to address conservation of raw materials and natural resources under the rules of the multilateral trading system.

9.2 Wildlife

The GATT, informed by WTO jurisprudence, clearly allows both import and export measures for the purpose of protection and conservation of wildlife. The *Shrimp/Turtle* cases discussed earlier demonstrate that compliance with GATT Article XX(b) or (g) as well as the chapeau of this Article will allow a WTO member to employ a measure that

[130] Ibid. paras. 7.314–7.318.
[131] Panel report, *China—Raw Materials*, para. 7.465; Panel report, *China—Rare Earths*, paras. 7.489–7.599.
[132] Panel report, *China—Raw Materials*, paras. 7.482–7.492.
[133] Panel report, *China—Rare Earths*, para. 7.844.

conserves or protects wildlife, especially species of wildlife that are in danger of extinction. In addition, in the *EC—Seal Products* case, discussed earlier, the Appellate Body upheld a new GATT exception that may be used to approve trade restrictions to protect wildlife: the Article XX(a) exception that provides a general exception for measures 'necessary to protect public morals'.

The *EC—Seal Products* case decided by a WTO Panel in 2013, discusses several important issues involving exceptions to import measures that may infringe WTO discrimination rules. The *Seal Products* case challenged an EU regulation prohibiting placing seal products on the market in the EU unless certain conditions were satisfied. The conditions in the regulation specified exceptions to the seal product ban: (1) seal products obtained from seals hunted by indigenous communities for their subsistence (the IC exception); (2) seal products obtained from seals hunted for marine resource management (the MRM exception); and (3) certain seal products brought into the EU by travellers (the travellers exception).

In the *Seal Products* case, the Panel first ruled that the conditional exceptions were technical regulations subject to the TBT Agreement since they specified product characteristics with which compliance is mandatory.[134] As technical regulations the EU seal product rules had to comply not only with the GATT but also with the various provisions of the TBT Agreement. Most importantly, the seal products regulation was subject to four separate legal tests for discriminatory treatment in international trade. First, Article 2.1 of the TBT Agreement requires both most favoured nation (MFN) and national treatment. Accordingly, if there is a disparate impact in connection with either obligation under a technical regulation it is not permitted unless the member demonstrates that this disparate impact stems from a legitimate regulatory distinction. Second, a separate non-discrimination obligation is contained in GATT Article 1:1, with three elements: (1) the showing of an advantage or favour; (2) that is not granted immediately and unconditionally; (3) to like products. Third, a separate non-discrimination obligation stems from GATT Article III:4, with three elements: (1) whether a measure is a law or regulation affecting the internal sale of a product; (2) whether the products at issue are like; and (3) whether imported products are accorded less favourable treatment. Fourth, still another non-discrimination obligation is contained in the GATT Article XX chapeau: the evenhandedness test for arbitrary and unjustifiable discrimination of this Article.

Applying these tests, the *Seal Products* Panel ruled (1) that the EU IC and MRM exceptions had a disparate impact not justified as a legitimate regulatory distinction, violating TBT Article 2.1.[135] The Panel also ruled that the EU Seal Trade Regime must comply with other provisions of the TBT Agreement.[136]

[134] Panel report, *EC—Seal Products*, paras. 7.82–7.105.

[135] Ibid. paras. 7.319 and 7.345. The Panel also tested the EU regulation under TBT Art. 2.2, finding that the regulation is capable of making a contribution toward a legitimate objective, addressing moral concerns, and for this purpose was not more trade restrictive than necessary (para. 7.505). The Panel also ruled that the EU regulation was a conformity assessment procedure that had to comply with TBT Art. 5; the Panel ruled that the regulation had the effect of creating unnecessary obstacles to international trade infringing this Article (para. 7.528).

[136] Ibid. paras. 7.505–7.528.

The Appellate Body, however, reversed the Panel on the issue of whether the EU Seal Trade Regime met the tests for a technical regulation that is subject to the TBT Agreement. The Appellate Body stated that to determine if a contested measure is a technical regulation, it must be considered as a whole, and, considered holistically, the EU Seal Trading Regime, with its three exceptions does not lay down characteristics that are intrinsically and closely connected with seal products as such. Rather, the conditions and exceptions for marketing imported seal products in the EU are administrative provisions, not product characteristics. Thus, the Appellate Body ruled that the Panel's analysis and findings with respect to the TBT Agreement were moot and of no effect.[137]

Nevertheless, the Appellate Body held that the EU Seal Trading Regime was discriminatory in violation of GATT Article 1:1. Applying the tests of GATT Article 1:1 (which are different from the tests of discrimination under the TBT Agreement), the Appellate Body upheld the Panel's conclusion that the EU Seal Trading Regime is inconsistent with Article 1:1 because it does not immediately and unconditionally extend the same market access to Canadian and Norwegian seal products that it extends to seal products from Greenland.[138]

As explained above, the Appellate Body then ruled that the EU Seal Trading Regime provisionally meets the tests for a general exception under Article XX(a), which applies to justify trade restrictions necessary to protect public morals. However, the EU Seal Trading Regime fails the discrimination tests of the chapeau of Article XX since it de facto allows IC seal products from Greenland to be sold in the EU, while excluding certain IC seal products from Canada on the grounds that the IC hunts are not for subsistence but are commercial in nature. Thus the Appellate Body ruled that the EU had not demonstrated compliance with the general exception of Article XX(a).

Despite the failure of the EU to justify the trade restrictions protecting seals under Article XX in the *EC—Seal Products* case, the Appellate Body's opinion in this case opens a wholly new avenue for the approval of trade restrictions to protect or conserve wildlife. In the future it would seem that Article XX(a) can be usefully employed for this purpose. In the *EC—Seal Products* case itself, it appears that the inconsistency with the chapeau can be readily corrected so that the Article XX(a) exception can be validated.

9.3 Forest products

The legitimacy of import and export restrictions on forest products for conservation purposes is largely untested in the WTO. On both the export and import sides, some measures would be clearly inconsistent with trade obligations, while other measures would seem to pass muster.

On the export side, a simple ban on the export of raw timber would almost certainly infringe WTO rules. For example, section 488 of the US Forest Resources Conservation and Shortage Relief Act of 1990 states that timber is essential to the United States; that forests, forest resources, and the forest environment are exhaustible natural resources

[137] Appellate Body report, *EC—Seal Products*, para. 570.

[138] Ibid. para. 5.130.

that require efficient and effective conservation efforts; that there is evidence of a shortfall in the supply of unprocessed timber in the United States; that any existing shortfall may worsen unless action is taken; and that conservation action is necessary so that exports of unprocessed timber are prohibited. Among the stated purposes of the Act are to take action necessary under the GATT Article XI:2(a) to ensure sufficient supplies of certain forest resources or products that are essential to the United States and to effect measures aimed at meeting these objectives in conformity with US obligations under the GATT.[139]

It is doubtful, however, whether this Act would survive the scrutiny of a WTO dispute settlement Panel. Under the authority of the *Canada—Herring and Salmon* case, which struck down a Canadian export ban on unprocessed herring and salmon because it was inconsistent with GATT Article XI:1, this Act contravenes the GATT, and neither possible exceptional justification seems to apply. Article XI:2(a) would not be applicable since there is no evidence that timber or timber products are in 'critical' short supply in the United States. Article XX(g) would not apply because the export restrictions must be 'in conjunction with restrictions on domestic production or consumption'. There are no such domestic restrictions on timber in the United States. In fact, there is ample evidence that timber production is subsidized by low government prices for standing timber on federal and state lands. It is more likely that the real purpose of the ban, then, is to create jobs in the domestic wood products industry by giving domestic mills the right to perform value-added processing.

Export conservation measures for forest resources must rather be crafted to comply with the GATT. Some measures that may be used include: (1) export taxes; (2) timber certification programmes that apply equally to forest products for export and for domestic consumption; (3) and restrictions on the sale and export of certain endangered species of trees. Moreover, a WTO member could enact moratoriums or prohibitions on new logging or timber operations; Indonesia in 2011, enacted a two-year moratorium on new logging and plantation concessions as part of its pledge under the climate change programme known as REDD Plus (Reducing Emissions from Deforestation and Forest Degradation). These measures would meet GATT standards.

On the import side, trade restrictions would have to comply with GATT Article XX(g). Import trade measures could target certain species of timber that are rare or endangered. Forest species that cannot be harvested without inflicting considerable damage to rainforests could also be legally targeted under GATT Article XX. Importing nations may also require importers of forest products to comply with local laws concerning timber cutting and removal. The United States' Lacey Act,[140] for example, prohibits importing timber or wood in violation of the environmental laws of timber producing countries. Timber producing and exporting countries now commonly employ timber certification standards determined and applied by not-for-profit associations such as the Forest Stewardship Council, based in Bonn, Germany, and require that forest products sold or exported must come from forests certified as meeting sustainable development standards.[141]

139 16 U.S.C. § 620 (1994).
140 16 U.S.C. § 3375(d).
141 See <http://www.fsc.org>.

9.4 Water

Water in bulk as well as water in bottles or cans is an article of commerce according to US and international law.[142] Water is thus subject to the GATT and water services are subject to the GATS. GATT Article XI limits trade barriers to the import and export of water to duties and taxes. Non-tariff restrictions on the import and export of water in bulk must comply with the GATT exceptions, Articles XI:2(a), XX(b), and XX(g).[143] Water trade, investments, and services are also potentially subject to free trade agreements, such as NAFTA.[144]

10. Environmental Standards and Process and Production Methods

Both environmental standards and regulation of their related processes and production methods are covered by one of two agreements, the TBT Agreement or the SPS Agreement. The Appellate Body has defined standards very broadly as including any mandatory regulation relating to the characteristics of a product.[145] Processes and production methods, which are covered by the TBT and SPS Agreements, are even more controversial than standards because they relate to how a product is made or produced in its country of origin.

10.1 Standards and technical regulations

Standards and technical regulations subject imported products to administrative scrutiny to determine whether their characteristics comply with set mandatory criteria.[146] All standards and technical regulations must comply with the disciplines of the TBT or SPS Agreements. Such regulations that are higher or different from internationally accepted norms carry a special burden of justification. The TBT and SPS Agreements are mutually exclusive,[147] so the first step in the analysis is to determine which Agreement applies to any particular measure.

The matter of what is needed to comply with each of the two Agreements is covered in Chapter 18.

[142] *Sporhase v Nebraska ex rel Douglas*, 458 US 941 (1982). The Harmonized Tariff Schedule Section 2201 defines water as including 'natural or artificial mineral waters and aerated waters, not containing added sugar or other sweetening matter nor flavored; ice and snow.'

[143] See generally, Edith Brown Weiss, Laurence Boisson de Chazournes, and Nathalie Bernasconi-Osterwalder, *Fresh Water and International Economic Law* (Oxford: Oxford University Press, 2005).

[144] See Steven Shrybman, 'Water Export Controls and Canadian International Trade Obligations' (2013), available at <http://www.waterbank.com/Newsletters/nws15.html>. In 1993, however, Canada, Mexico, and the United States signed a non-binding declaration stating that water in bulk is not covered by the provisions of any trade agreement. Ibid. 5.

[145] Appellate Body report, *EC—Asbestos*, paras. 66–75.

[146] Ibid. para. 75.

[147] TBT Agreement Art. 1.5.

10.2 Process and production methods

In addition to placing environmental trade measures on products, import restrictions may also regulate how a product is produced, manufactured, or obtained, commonly referred to as process and production methods (PPMs). Some PPMs are related directly to the characteristics of the products concerned. For example, pesticides used on food crops produce residues on food products; cattle raised on growth hormones produce meat with hormone residues; and unsanitary conditions in slaughterhouses result in meat that may be contaminated with disease-causing organisms. The TBT and SPS Agreements cover PPMs such as these. Other PPMs, however, are not reflected in the characteristics of the associated product. For example, whether a polluting or non-polluting process produces steel is irrelevant to its specifications, although it may be very important for environmental protection.

The latter type of PPM probably cannot be justified under either the SPS or TBT Agreements. The SPS Agreement, by its terms, covers only PPMs designed to protect humans, animals, and plants within the territory of the trade-restricting state.[148] This would exclude PPMs designed to improve the environment of the exporting state. Similarly, the TBT Agreement states that PPMs in the form of technical regulations must be justified as necessary to the fulfilment of a legitimate objective,[149] including protection of the environment, but the context is clear that this refers to the environment of the trade-restricting member, not the territory of the exporting member.

The GATT ruling opposed to PPMs comes from the now infamous *Tuna Dolphin* cases. In these cases, the PPM involved catching tuna by setting fishing nets on schools of dolphins without requiring precautions to spare the dolphins. When the United States banned imports of tuna caught by such methods, two GATT dispute settlement Panels declared this action inconsistent with GATT norms on the ground that it discriminated between 'like' products.[150] Thus, a state cannot adopt different treatment for two products with the same physical characteristics based on how the products have been produced or harvested.[151]

Two different groups have opposed these controversial rulings. Environmentalists regard them as a setback to the goal of protecting ecosystems all over the world as well as the global commons. Others fear unfair competition from pollution havens, countries that maintain different conditions of production, particularly with respect to environmental, health and safety laws, and workers' rights and pay. This group wants the ability to 'level the playing field' by prohibiting imports from any country that refuses to adopt laws and regulations mirroring those of the importing country.

Scholars sympathetic to one or both of these views have called on the WTO to repudiate the *Tuna Dolphin* rulings by (1) redefining 'like product' in GATT Article III so that products could be considered 'unlike' on the basis of how they are made,

[148] SPS Agreement Annex A, para. 1. [149] TBT Agreement Art. 2.2.
[150] See *Tuna Dolphin I* and *Tuna Dolphin II*.
[151] Another example of a PPM controversy is the EU proposal to prohibit the import of pelts and manufactured goods of certain animal species caught or killed by methods using leg-hold traps. See Council Regulation 3254/91, 1991 O.J. (L 308) 1.

produced, or harvested;[152] (2) adopting countervailing or 'eco-dumping' duties on products from countries that some believe constitute 'pollution havens' where products are made without adequate environmental controls;[153] or (3) employing a new method of balancing trade and environmental interests by analysing the intent or effect of the measure, the legitimacy of the environmental policy, and the justification for the disruption to trade.[154] The first and second of these proposals could be implemented only by amendments to the GATT.[155] There are powerful arguments—both political and legal—against these ideas. Allowing trade restrictions on the basis of PPMs, however well intended, would allow trade to be restricted willy-nilly on the basis of any member's pet peeve and ultimately would favour only large countries able to throw their weight around. Although the term 'like product' is defined flexibly on a case-by-case basis,[156] it would be a radical shift to differentiate products based on how they are produced, manufactured, or harvested.

The enforcement of PPMs in other countries also could be encouraged by replacing the current legal tests with a more lenient test that would allow WTO dispute settlement Panels to balance the legitimacy of the protected environmental value with the disruption to trading interests.[157] However, this proposal, which is derived from the way the US Supreme Court decides Commerce Clause cases,[158] may be unsuited to international tribunals like WTO Panels whose ad hoc judges would, thereby, be delegated extraordinary discretion. Under this scheme, many PPM regulations undoubtedly would be upheld, but in the international context, this would encourage nations to violate fundamental principles of public international law, which, for the sake of harmony among nations, restrict the exercise of jurisdiction to accepted normative concepts.[159]

Fortunately, the GATT rule taking a hard line against all PPM import restrictions that are not based on product characteristics has been modified under the WTO. This is one of the most important aspects of WTO jurisprudence.

There are two theoretical ways of permitting PPM trade restrictions under the GATT. One is to allow them under Article III, the national treatment provision. Important scholarship[160] has contended that Article III provides no support, by its terms, for the PPM distinction or the proposition that Article III precludes process

[152] See Snape and Lefkovitz, 'Searching for GATT's Environmental Miranda', n. 35 at 788–92.

[153] See Esty, *The Greening of the GATT* (1994), n. 11 at 163–8.

[154] Ibid. 114–16; Steve Charnovitz, 'The Law of Environmental "PPMs" in the WTO: Debunking the Myth of Illegality' (2002) *Yale J. Int'l L.* 27, 59.

[155] Eco-dumping and countervailing duties are not authorized under the WTO Subsidies and Countervailing Duty Agreement or current US law. For analysis of whether low environmental standards can be treated as subsidies or dumping, see Robert E. Hudec, 'Differences in National Environmental Standards: The Level-Playing-Field Dimension' (1995) *Minn. J. Global Trade* 5(1), 14–21.

[156] See *Japan—Alcoholic Beverages* (Appellate Body).

[157] See Esty, *The Greening of the GATT* (1994), n. 11 at 114–18.

[158] See, for example, *Huron Cement Co. v Detroit,* 362 US 440 (1960); see also Daniel Farber and Robert E. Hudec, 'Legal Restraints on Domestic Environmental Standards' in Robert E. Hudec and Jagdish Bhagwati, eds., *Fair Trade and Harmonization* 1 (Cambridge, Mass.: MIT Press, 1996), 59, 64–88.

[159] See generally Ian Brownlie, *Principles of Public International Law*, 5th edn. (Oxford, UK: Clarendon Press, 1998) ch. 15.

[160] Robert Howse and Donald Regan, 'The Product/Process Distinction—An Illusory Basis for Disciplining Unilateralism' (2000) 11 *EJIL* 249.

measures. But this is the very argument that was considered and rejected in the *Tuna Dolphin* cases. The major problem with interpreting Article III in this fashion is that it opens the door too wide. Every kind of PPM, no matter how irrational or silly, may be permitted.

The WTO Appellate Body has developed a more limited, but principled, way of permitting PPMs based on GATT Article XX. As Charnovitz[161] has carefully argued, the *Shrimp/Turtle* case crafted a tailored exception based on GATT Article XX for environmental PPMs. In this case the Appellate Body built upon the foundation established in the *US Reformulated Gasoline* case. As detailed above,[162] a PPM (such as requiring turtle excluder devices when fishing for shrimp) will be permitted if it meets the tests for the application of Article XX. This Article embodies two categories of test. The first is *substantive*. The standards for the application of Article XX(g) and XX(b) involve meeting specific substantive criteria.[163] The second—the criteria of the chapeau of Article XX—is *procedural*. In addition to the substantive tests of Article XX, a PPM, to be permitted, must not be discriminatory or arbitrary.[164] WTO jurisprudence has cut the Gordian knot—to permit certain environmental PPMs without creating an exception that would swallow other GATT rules.

Instead of allowing unilateral regulation of PPMs to deal with environmental protection/pollution haven problems, other approaches might be considered, such as environmental agreements, environmental management systems, and investment standards.

10.2.1 Environmental agreements

The PPM/pollution haven problem can be dealt with directly by encouraging countries to negotiate environmental agreements. First, if PPMs are causing transboundary pollution, the states concerned, relying on well-established principles of state responsibility under international law, may enter into an agreement to abate the pollution and compensate for its damage.[165] Where the problem is serious, as in the border region between the United States and Mexico, new institutions may be required both to deal with the pollution and to upgrade the environmental enforcement of the lax country concerned. Thus, the United States and Mexico have created a US–Mexican International Boundary Water Commission,[166] a Border Plan, and a Border Environmental Cooperation Agreement.[167] Mexico, Canada, and the United States have created a trilateral Commission for Environmental Cooperation to promote enforcement of environmental laws in the three countries.

[161] Steve Charnovitz, 'The Law of Environmental "PPMs" in the WTO', n. 154 at 59.
[162] Section 5.1. [163] Sections 5.1 and 5.2.
[164] See the discussion in section 5.3.
[165] See, for example, 'Trail Smelter Arbitration' (1939) *Am. J. Int'l L.* 33, 182; 'Trail Smelter Arbitration?' (1941) *Am .J. Int'l L.* 35, 684; 1991 Canada–US Agreement on Air Quality, 30 I.L.M. 676.
[166] 22 U.S.C. §§ 277–278b (1994). See Stephen Mumme, 'Innovation and Reform in Trans-boundary Resource Management: A Critical Look at the International Boundary and Water Commission, United States and Mexico' (1993) *Nat. Resources J.* 3, 93.
[167] See Robert Housman, *Reconciling Free Trade and the Environment: Lessons from the North American Free Trade Agreement* (Geneva, Switzerland: United Nations Environment Programme, 1994).

Second, a specific problem may be addressed either through a bilateral or multilateral agreement designed to deal with it. An example is the *Tuna Dolphin* dispute itself, which was addressed by the 1992 Agreement for the Reduction of Dolphin Mortality in the Eastern Pacific Ocean.[168] The Agreement has been implemented so successfully that scientists say that the eastern Pacific is now the 'world's safest tuna fishery for dolphins'.[169]

Third, regional pollution control agreements could be adopted following the model of the UNEP Regional Seas Programme.[170] Under that programme, 'framework' conventions have been concluded to preserve marine ecosystems in the Persian Gulf, the Red Sea and the Gulf of Aden, the South Pacific, and the Caribbean; and the East African side of the Indian Ocean, the Latin American side of the southeast Pacific, and the West African side of the South Atlantic. These agreements are comprehensive in their regulation of all sources of marine pollution; they are models for facilitation cooperation and technical assistance, and new protocols can be added as needed to focus on particular pollution problems. A similar system of regional treaties could foster higher environmental PPMs, as well as control pollution on an appropriate regional basis.

Fourth, appropriate international organizations can encourage the transfer of environmentally friendly technology[171] through development assistance or foreign direct investment. Thus, countries would upgrade PPMs in return for assistance in acquiring environmentally enhancing technology. In this way, as countries develop particular industrial sectors, they would acquire the means to control the environment consequences. The transfer of technology also would promote voluntary standardization of PPMs. To some extent, this already is happening under international treaty regimes for the control of ozone-depleting substances and climate change.

10.2.2 Environmental management systems

Many environmentalists saw the *Tuna Dolphin* decisions as an obstacle to the maintenance of high environmental standards because these decisions invalidated efforts to require environmentally protective PPMs in other countries. How should the WTO respond to these concerns? Should international minimum PPM standards be required?

The term 'environmental standards' has various meanings. It can refer to the characteristics of products, PPMs, the cleanliness of the ambient environment, or procedural requirements. There are three general approaches to the international treatment of product standards: (1) national treatment, where each country determines

[168] Agreement for the Reduction of Dolphin Mortality in the Eastern Pacific Ocean, 33 I.L.M. 936 (1994).

[169] 'Dolphin Slaughter Ended' *Int'l Herald Trib.*, 26 June 1996, 5.

[170] See Matthew Hulm, *A Strategy for the Seas: The Regional Seas Programme, Past and Future* (Geneva, Switzerland: United Nations Environment Programme, 1983).

[171] This idea, advanced by Rege, 'GATT Law and Environment-Related Issues Affecting the Trade of Developing Countries', n. 93 at 113–16, is already occurring to some extent through environmental agreements and the Global Environmental Facility.

its own standards and applies them to imported products; (2) mutual recognition, where countries agree to recognize each other's standards; and (3) harmonization, where, through negotiation, countries agree to adopt identical or similar standards, which therefore become international.

The WTO/GATT system, through the TBT and SPS Agreements, relies primarily on the first and third approaches, encouraging harmonization and the adoption of international standards, but permitting national treatment. Empirical studies evaluating WTO/GATT harmonization of product standards find that, other than 'interface' harmonization (for example, weights and measures), it has had very limited success, because the costs and benefits of harmonization are incommensurable, so that most countries perceive it as a lose–lose exchange.[172] If harmonization of product standards on a worldwide basis has proved difficult, harmonizing PPMs would be impossible. There also are valid economic and environmental reasons why process standards should not be identical on a worldwide basis.[173] In addition, the putative international race to the bottom has been much exaggerated. Actually, there is much evidence that trade between nations improves environmental standards of all kinds.[174]

If requiring worldwide PPM harmonization is not the answer, what can be done to ameliorate the PPM/pollution haven problem? PPMs can be upgraded through private efforts to protect the environment by means of corporate responsibility programmes and widespread adoption of environmental management systems such as the ISO 14000 Series.[175] ISO 14001 was developed by the International Standards Organization to identify the core elements of a voluntary environmental management system that would call on organizations to conduct their environmental affairs within a structured system integrated with ordinary management activity. The elements of such a corporate system are (1) adoption of a senior management level environmental policy; (2) identification of the key environmental aspects of a company's operations; (3) identification and implementation of legal requirements; (4) identification of quantifiable environmental targets and objectives; (5) establishment of an environmental management system that allocates responsibility for environmental improvement; (6) training of employees; (7) establishment of monitoring, auditing, and corrective action; and (8) establishment of management review and responsibility. The ISO 14001 EMS is not limited to compliance but focuses on pollution prevention as well.

ISO 14001 is becoming established as the internationally accepted voluntary standards system of environmental management. Many companies are moving to adopt this system, and there is every indication that adherence to it will become a prerequisite for access to international markets. ISO 14001 does not establish specific PPMs or

[172] See David W. Leebron, 'Laying Down Procrustes: An Analysis of Harmonization Claims' in Hudec and Bhagwati, eds., *Fair Trade and Harmonization* 1 (1996), n. 158 at 41.

[173] See Richard B. Stewart, 'Environmental Regulation and International Competitiveness' (1993) *Yale L.J.* 102, 2039, 2051–7.

[174] See Alessandra Casella, 'Fair Trade and Evolving Standards' in Hudec and Bhagwati, eds., *Fair Trade and Harmonization* 1 (1996), n. 158 at 119; John Douglas Wilson, 'Capital Mobility and Environmental Standards: Is There a Theoretical Basis for the Race to the Bottom?' in Hudec and Bhagwati, eds., *Fair Trade and Harmonization* 1 (1996), n. 158 at 393.

[175] See Naomi Roht-Arriaza, 'Shifting the Point of Regulation: International Organization for Standardization and Global Lawmaking on Trade and the Environment' (1995) *Ecology L.Q.* 22, 479.

standards for pollution control. Rather, it requires companies to commit themselves to continual improvement of their environmental management systems' compliance with applicable laws and pollution prevention, but it leaves each company free to implement individual solutions to pollution and negative externality problems. Although adoption of ISO 14001 is voluntary, governments can provide incentives for its use through relief from 'command and control' regulation, enforcement policies that impose reduced penalties, and environmental privilege guarantees for companies that implement it.

10.2.3 Investment

An important aspect of the pollution haven problem is the charge that countries with lax pollution standards attract industry and jobs away from countries with high standards. Empirical studies, however, fail to show much evidence of this loss of jobs.[176] The United States and other OECD countries enforce similar environmental standards and spend about the same to control pollution, about 2 per cent of gross domestic product.[177] Even though certain developing countries have lower pollution standards and there is anecdotal evidence of job losses, empirical evidence again suggests cost differences in environmental standards play little role in company location decisions.[178] Environmental compliance costs in most industries are only a small percentage of production costs and cost differences in raw materials and wages are probably more significant.[179]

Nevertheless, it may be wise for the WTO to counter this concern by adopting an amendment to the TRIMs Agreement[180] or a broader Multilateral Agreement on Investment, if one is negotiated.[181] A model might be the NAFTA provision on Environmental Measures:

> The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.[182]

[176] See Robert Carbaugh and Darwin Wassink, 'Environmental Standards and International Competitiveness' (1992) *World Competition* 16(1), 81.

[177] Ibid. 87–8.

[178] Jeffrey Leonard, *Pollution and the Struggle for World Product* (Cambridge, UK: Cambridge University Press, 1988); Charles Pearson, *Down to Business: Multinational Corporations, the Environment and Development* (Washington, DC: World Resources Institute, 1985).

[179] Carbaugh and Wassink, 'Environmental Standards and International Competitiveness', n. 176 at 88–90.

[180] The TRIMs Agreement was one of the key agreements of the GATT Uruguay Round.

[181] A proposed OECD Multilateral Agreement on Investment was abandoned in 1998. See Chapter 19, section 4 and Yoshi Kodoma, 'The Multilateral Agreement on Investment and Its Legal Implications for Newly Industrialising Economies' (1998) *J. World Trade* 32, 21. However, trade and investment is on the tentative agenda for a future WTO negotiating round.

[182] NAFTA Art. 1114(2).

Such a provision would not require any specific level of pollution control in the country where the investment is located, but it would set up a channel of complaint if environmental laxity is used to attract investment.

11. Recycling and Packaging

Several countries have taken bold steps to introduce mandatory recycling of products and packaging to reduce the generation of waste and the resulting pollution and need for landfills. Germany has led the way, passing the *Verpackungsverordnung* (Packaging Ordinance)[183] in 1991, which regulates the packaging of products and sets mandatory recycling requirements for packaging waste. The Packaging Ordinance requires the manufacturers of products to take back packaging wastes and to arrange for their recycling. They fulfil this duty by participating in a private waste collection system, which, for a fee, will handle this obligation by collecting waste from consumers. Participating manufacturers may mark their products with a green dot. The Packaging Ordinance applies to all products distributed within Germany.[184]

Largely because of this German initiative and in order to harmonize Member State legal regimes, the European Union adopted a Packaging Directive in December 1994.[185] The EU directive sets target ranges for packaging waste recovery and recycling, standardizes methods of analysing product life cycles and measuring toxicity of packaging components and waste, and sets maximum concentration levels for heavy metals in packaging. The directive applies to the packaging of all products sold in the EU, including imports.[186]

These laws are part of an increasing trend in many industrialized countries to consider the environmental impact of products throughout their life cycles to the point of their ultimate disposal. The purpose of these laws is to lessen a product's environmental impact by (1) minimizing packaging waste; (2) prohibiting the use of toxic and hazardous materials in packaging; and (3) creating incentives or requirements for recycling, re-use, or proper disposal of both the packaging and the products themselves. Such laws have the potential to disrupt international trade. Manufacturing groups are alarmed that the spread of such life cycle or producer responsibility laws will have a protectionist effect, isolating national markets. Developing countries are especially concerned that their exporters will be unable to comply with these laws.

Nevertheless, life cycle laws serve important purposes and the international trading system should be adjusted to accommodate them. Two separate sets of issues arise. The most serious problems come from the proliferation of such laws rather than their substantive requirements. If every country adopts its own national (or sub-national)

[183] 20 August 1991 BGBl I S 1234, translated in 21 I.L.M. 1135 (1992). For commentary, see Stephanie A. Goldfine, 'Using Economic Incentives to Promote Environmentally Sound Business Practices' (1994) *Geo. Int'l Envtl. L. Rev.* 7, 309.

[184] Bundesministerium für Umwelt, Naturschutz, and Reaktorsicherheit, *The Packaging Ordinance and International Trade* § 1(1), 23 June 1993.

[185] Council Directive 94/62, 1994 O.J. (L 365) 10. See generally Alexandra Haner, 'Will the European Union's Packaging Directive Reconcile Trade and the Environment?' (1995) *Fordham Int'l L. J.* 18, 2187.

[186] Council Directive 94/62, n. 185 at para. 2(1).

system, trade will be disrupted by the burden of satisfying many different national bureaucracies. Moreover, though well intentioned, some packaging or product regulations may be environmentally harmful. The problems stemming from proliferation could be alleviated through international harmonization of product life cycle regulation. This should be encouraged by the WTO CTE, but is probably best left to private groups like the International Standards Organization that can work with national governments, industry, and environmental interest groups. Harmonization efforts should emphasize environmental protection, but should screen carefully the current array of laws for effectiveness, and eliminate those that are not working. The second problem with such laws is that they may be more restrictive than necessary or may discriminate intentionally or unintentionally against foreign producers. To ensure that this does not happen, they should be held to scrutiny under international trade law norms that recognize the necessity of environmental protection for national governments to have some flexibility in the remedies they adopt.

In principle, product life cycle and producer responsibility laws are permitted under GATT Article III as long as they apply equally to domestic and foreign producers. These laws are also subject to the discipline of the TBT Agreement, which imposes the additional requirements that they must not create 'unnecessary obstacles to international trade' and not be 'more restrictive than necessary to fulfil a legitimate objective', including, of course, protection of the environment.[187] These tests ensure that a proper balancing process will be applied so that restrictive measures are not out of proportion to their benefits.[188]

12. Eco-labelling

Another method of raising environmental standards is through eco-labelling. The theory behind eco-labels is that if consumers are informed, the market and consumer choice can be relied on to stimulate the production and consumption of environmentally friendly products.[189] A great variety of eco-labelling schemes exist, sponsored by governments, private groups, or a combination of the two. They take several forms: mandatory negative content labelling, mandatory content neutral labelling, and voluntary multi-criteria labelling.[190] Eco-labels can show product characteristics or process and production methods (PPMs). They can operate as a seal of approval or objectively impart information. Well-known examples of eco-labelling plans include Germany's Blue Angel programme and the White Swan mark launched by the

[187] TBT Agreement Art. 2.2 and Annex I, para. 1.

[188] A useful balancing test that might be employed is the concept of proportionality. See the *Danish Bottles* case. There, the ECJ upheld a ban on non-returnable beverage containers, but held that a limitation on the sale of non-approved containers was discriminatory against foreign producers and out of proportion to the benefits served.

[189] See H. Ward, 'Trade and Environmental Issues in Voluntary Eco-Labelling and Life Cycle Analysis' (1997) *Reciel* 6, 139; S. Subedi, 'Balancing International Trade and Environmental Protection' (1999) *Brooklyn J. Int'l L.* 2, 373. For a sceptical view, see H. Mennell, 'The Uneasy Case for Eco-labelling' (1995) *Reciel* 4, 304.

[190] US Environmental Protection Agency, Status Report on the Use of Environmental Labels Worldwide (1993).

Scandinavian countries.[191] In the United States, a private organization operates a Green Seal programme. Increasingly, governments are adopting such programmes.[192] In 1992, the European Union established an eco-label scheme to 'promote the design, production, marketing, and use of products which have a reduced environmental impact during their entire lifecycle, and provide consumers with better information on the environmental impact of products'.[193]

Eco-labelling must comply with WTO/GATT requirements. Even mandatory eco-label requirements on products would be permissible if they are applied on a non-discriminatory basis, adhering to the GATT 1994 MFN and national treatment requirements. For example, under the US Energy Policy and Conservation Act,[194] corporate average fuel economy standards for automobiles must be calculated for domestic manufacturers and importers, and new automobiles sold in the United States must bear a label stating the estimated miles-per-gallon rate for city and highway use.[195] This programme was the subject of a GATT Panel report in the *US—Taxes on Automobiles* case,[196] which upheld the standards except for the separate foreign fleet accounting aspects, which discriminated unfairly against foreign manufacturers.

Even eco-label schemes that pertain to PPMs may be upheld if they adhere to MFN and national treatment norms. In the *Tuna Dolphin* case, the Panel accepted the voluntary dolphin safe labelling scheme for tuna products sold in the United States:

> [T]he labeling provision of the [US law] do not restrict the sale of tuna products; tuna products can be freely sold both with and without the "Dolphin Safe" label. Nor do these provisions establish requirements that have to be met in order to obtain an advantage from the government. Any advantage which might possibly result from access to this label depends on the free choice by consumers to give preference to tuna carrying the "Dolphin Safe" label. The labeling provisions therefore did not make the right to sell tuna or tuna products, conditional upon the use of tuna harvesting methods.[197]

In contrast, a discriminatory PPM labelling scheme would not be upheld. One that singled out wood products made from tropical forests might fail if like products from temperate forests were not included.[198]

Mandatory labelling schemes must also comply with the TBT Agreement, which applies to any technical regulation that deals with a product characteristic, including 'terminology, symbols, packaging, marking or labeling requirements as they apply to a product, process or production method'.[199] The Agreement requires that eco-labels 'fulfill a legitimate

[191] See Elliott B. Stafin, 'Trade Barrier or Trade Boon: A Critical Evaluation of Environmental Labeling' (1996) *Colum. J. Envtl. L.* 21, 205, 225.

[192] Ibid. 230–2.

[193] Commission Regulation 880/92, Art. I, 1992 O.J. (L 99) 1.

[194] 17 U.S.C. § 4001 (1994).

[195] 40 C.F.R. pt. 600 (1996).

[196] *US—Taxes on Automobiles*, DS31/R, 11 October 1994, reprinted in 33 I.L.M. 1397, para. 5.10 (1994) (unadopted).

[197] *Tuna Dolphin I*, para. 5.42. For a dissenting view that PPM labels would pass GATT muster, see Eric P. Bartenhagen, 'NOTE: The Intersection of Trade and the Environment: An Examination of the Impact of the TBT Agreement on Ecolabeling Programs' (1997) *Va. Envtl. L. J.* 1.

[198] See Chase, 'Tropical Forests and Trade Policy: The Legality of Unilateral Attempts to Promote Sustainable Development Under the GATT, n. 14.

[199] TBT Agreement Annex 1, para. 1.

objective', not be 'more trade-restrictive than necessary', and comply with notice and transparency requirements, including the TBT Code of Good Practice.[200]

In 2011, three WTO Panel reports were handed down on the subject of product labelling, one of which revisited the tuna/dolphin controversy between Mexico and the United States. In *US—Tuna II (Mexico)*,[201] Mexico challenged US labelling standards for 'dolphin safe' tuna under the US Dolphin Protection Consumer Information Act.[202] Mexico contended that the US standards, which excluded tuna caught by setting nets on dolphins, as is the Mexican practice in the Eastern Tropical Pacific (ETP), was discriminatory, and more trade-restrictive than necessary. The WTO Panel, after concluding (one panellist dissenting) that the US dolphin safe labelling requirements were 'technical regulations' under the TBT Agreement made three key rulings. First, the Panel rejected the Mexican argument that US regulations were inconsistent with TBT Article 2.1, which forbids 'less favourable treatment' to imports, because the Panel found that the labelling requirements applied equally to all fishing fleets regardless of flag. Second, the Panel ruled that the US regulations were inconsistent with TBT Article 2.2, because, although the US objectives—consumer protection and dolphin conservation—were 'legitimate', the US regulations were 'more trade restrictive than necessary' because the United States failed to take into account the labelling standards and the negotiations resulting in the 1999 Agreement on the International Dolphin Conservation Program (AIDCP) initiated by the Inter-American Tropical Tuna Commission. Third, the Panel ruled that, although the AIDCP qualifies as an international standardizing organization, and the AIDCP dolphin safe definition and certification are a 'relevant international standard', the United States' regulations did not infringe TBT Article 2.4 for failing to base its dolphin safe labelling on a relevant international standard because Mexico had not met the burden of showing that the AIDCP standard was an effective means of satisfying the US objectives.

Additional steps should be taken by the WTO CTE to ensure that eco-labelling does not become a barrier to trade. First, eco-label schemes might be required to be registered with the WTO so that transparency is guaranteed. National eco-label systems should also be open to all producers on a non-discriminatory basis, not contain requirements that favour domestic producers or be too costly or difficult to meet. Environmental labelling has been a designated subject of negotiation since the Doha Ministerial Conference. Clarification is needed on international standards for environmental labelling.

13. The Export of Hazardous Substances and Wastes

13.1 Domestically prohibited goods

Domestically prohibited goods are products whose sale and use are restricted in a nation's domestic market on the grounds that they present a danger to human, animal,

[200] TBT Agreement Annex 3.
[201] *US—Tuna II* (Mexico) Panel report (2011); Appellate Body report (2012).
[202] 16 U.S.C. § 1385 and 50 C.F.R. § 216.91.

or plant life, health, or the environment. They include unregistered pesticides, expired pharmaceuticals, alcohol, tobacco, dangerous chemicals, and adulterated food products. For example, in the United States, the export of unregistered pesticides is permitted only under a system of notice that requires prior informal consent.[203]

Clearly, a state may bar imports of a product that is banned for domestic sale or consumption. Can exports of such products also be restricted? A GATT working group addressed this issue in 1991,[204] but there was no consensus on its report; the issue was transferred to the agenda of the CTE. This was followed in 1998 by the negotiation of a treaty[205] establishing a prior informed consent (PIC) regime for banned or restricted chemical products and hazardous pesticide formulations that may cause health or environmental problems. The international shipment of these products would be barred without the prior notice and explicit consent of a designated national authority in the destination country. Do these export control and PIC regimes for dangerous products conform to WTO rules? Would it be permissible for a state to go beyond PIC and adopt a total ban on the export of certain categories of domestically prohibited goods?

A PIC restriction or a total ban may be carried out within current established legal limits. GATT Article XX(b) allows trade measures (affecting either imports or exports) that are 'necessary to protect human, animal, plant life or health'. Moreover, according to the *Tuna Dolphin II* and *Shrimp/Turtle* cases, nothing in Article XX prevents a state from imposing a trade measure to protect the health or safety of persons or the environment located outside the territory of that state. Under this interpretation, a PIC export regime or a total export ban would be justified.

However, further clarification by the CTE would remove any remaining uncertainty by reaffirming the requirements of current law and stating explicitly that they apply to domestically prohibited goods. The CTE also could adopt transparency requirements that would compel trade-restricting states to notify the WTO and publish in full all laws, regulations, and decisions relating to the products concerned. The WTO would thus provide a clearinghouse for the notification and publication of domestically prohibited goods restrictions, and they would be fully subject to the WTO dispute resolution regime.

13.2 Waste

Export of hazardous wastes has received great attention from the international community. The Basel Convention on the Control of Trans-boundary Movements of

[203] 7 U.S.C. § 1360 (1994).

[204] See Report by the Chairman of the GATT Working Group in Export of Domestically Prohibited Goods and Other Hazardous Substances, GATT Doc. L/6872 (1991). This group recommended a code that would allow individual member states to decide whether their domestic restrictions should be carried over to exports.

[205] The 1998 Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade, 38 I.L.M. 1 (1999). The 2001 Stockholm Convention on Persistent Organic Pollutants (POPS) further prohibits or restricts trade in a variety of pesticides and chemicals, available at UNEP website, <http:www.unep.ch/pops>.

Hazardous Wastes and Their Disposal (1989)[206] requires prior notification and informed consent of the receiving country as a precondition for authorizing international waste shipments. Furthermore, the Convention provides that parties must prohibit the export of the waste whenever there is reason to believe that it will not be managed in an environmentally sound manner.

Two aspects of the Basel Convention raise problems with respect to WTO rules. First, the conference of the parties adopted an amendment to ban the export of hazardous wastes from industrialized countries (the OECD, the EU, and Liechtenstein) to developing countries. The ban applies both to hazardous waste intended for disposal and, from the end of 1997, to hazardous waste intended for re-use or recycling. Second, Article 4(5) of the Convention prohibits export and imports of hazardous and other wastes between parties and non-party states. These trade restrictions on wastes are based on experience and future fears concerning the exploitation of developing countries. They also reflect certain principles adopted at the 1992 UN Conference on Environment and Development, notably Principle 14 of the Rio Declaration, which provides that states should cooperate to prevent the movement of materials harmful to the environment and humans, and Principle 19, which requires prior notice to potentially affected states with regard to potentially harmful activities.

The international regime for the transboundary movement of hazardous wastes is in marked contrast to that in effect domestically in the United States, where the Supreme Court has struck down state-imposed limitations on the import of hazardous waste as violating constitutional norms under the Commerce Clause.[207] On the other hand, the European Court of Justice in the *Belgian Waste* case[208] stated that waste can be a threat to the environment because of the limited capacity of each region or locality to receive it. Accordingly, the Court ruled that it is permissible under Articles 30 and 36 of the EC Treaty for a locality to adopt an import ban unless this is inconsistent with EC legislation.[209] The Court based its decision on the proximity principle—that wastes should be treated at their source—and the importance of self-sufficiency regarding waste. The Court's ruling would seem to allow export as well as import restrictions on waste.

An export ban on hazardous wastes may be justified under GATT Article XX(b) on the same basis as export restrictions on domestically prohibited goods. Hazardous wastes have the potential to endanger human health and the environment; thus, Article XX(b) may be interpreted to allow export bans to protect areas outside the territory of the trade restricting country. Even a discriminatory export ban may be upheld under Article XX(b) if the discrimination is not 'arbitrary or unjustifiable . . . between countries where the same conditions prevail'. A ban that distinguishes between OECD and

[206] 28 I.L.M. 649 (1989).

[207] For example, *City of Philadelphia v New Jersey,* 437 US 617 (1978).

[208] Case C-2/90, *Commission v Belgium* [1992] E.C.R. I-4431, 1 C.M.L.R. 365.

[209] The Court upheld the ban as regards the importation of non-hazardous waste not covered by a Council directive. However, the Court ruled that to the extent that the ban related also to hazardous waste, Belgium had failed to fulfil its obligation to comply with Council Directive 84/631. Ibid. paras. 38–9.

developing countries, arguably at least, could pass this test because of the very different conditions in developing countries. Thus, emerging international hazardous waste regimes seem reconcilable under the WTO/GATT system.

The question of a ban on *imports* of products contributing to waste was raised in the case *Brazil—Retreaded Tyres* (2007).[210] This case involved Brazil's import ban of retreaded tyres, which it justified on the basis that it was necessary to reduce tyre waste within Brazil. The complaining WTO member, the EC, argued that the purpose of the ban was really to protect Brazil's domestic tyre industry from foreign competition. Since the import ban was a violation of GATT Article XI, the Panel and the Appellate Body examined whether the ban was justified under GATT Article XX(b) as necessary to protect human, animal or plant life or health. Both the Panel and the Appellate Body ruled that the two-part test under Article XX(b) was satisfied: the policy behind the import ban was within the scope of the range of policies covered by Article XX(b), and the import ban was necessary to fulfil the policy objective.[211] The case is notable for the fact that the connection was made between a trade policy that was found to be designed to reduce waste and the policy mandate of Article XX(b), which is an exception to protect human, animal and plant life and health. The Panel made an explicit connection between waste minimization and the policy of Article XX(b), ruling that tyre waste reduction would contribute to the protection of human, animal, and plant life and health in that fertile breeding grounds for disease will be reduced and the risk of tyre fires will likewise be less.[212] Thus, the *Brazil Tyres* case aligns WTO law in accord with the waste minimization principle of the Basel Convention and increases the likelihood of consistency on the export side as well.

The *Brazil Tyres* case also interpreted the 'necessary' element of GATT Article XX (b) to accord with the environmental policies of waste reduction and local disposal of wastes (the proximity principle) features of the Basel Convention. The necessity determination was made by the Panel by weighing and balancing four elements: (1) the importance of the measure's objective; (2) its trade restrictiveness; (3) the contribution of the measure to the objective; and (4) the availability of alternative measures. In its consideration of alternative measures the Panel explicitly discounted landfilling and stockpiling of waste tyres and stated that even material recycling may not be entirely safe. The Panel found that 'Brazil has demonstrated that they would not be able to dispose of a quantity of waste tyres sufficient to achieve Brazil's desired level of protection due to their prohibitive costs.'[213] This ruling was upheld by the Appellate Body.[214] Thus, *Brazil Tyres* represents an important environmental case, although the import ban failed the test of the chapeau of Article XX since Brazil allowed retreaded tyre imports to continue from its MERCOSUR free trade agreement partners.[215]

[210] WT/DS332/R, Panel report, 12 June 2007; WT/DS332/AB/R, Appellate Body report, 17 December 2007.

[211] Ibid. Panel report, paras. 7.40–7.41; Appellate Body report, para. 212.

[212] Ibid. Panel report, paras. 7.108–7.112.

[213] Ibid. Panel report, para. 7.208.

[214] Ibid. Appellate Body report, paras. 199–209.

[215] Ibid. para. 233.

14. Environmental Taxes

Many commentators have called on governments and public authorities to use market-based economic incentives[216] rather than command-and-control regulation to improve environmental quality. As a result, taxes may be used more frequently in the future, both to raise revenue and to achieve environmental goals. Environmental taxes are based on the principle that many resources are underpriced and, therefore, overused. Environmental taxes, in effect, raise the price of the use of these resources. They have three purposes: (1) to discourage the consumption of goods and services that create environmental costs; (2) to encourage producers to develop alternative production methods and products that are less harmful to the environment; and (3) to implement the polluter pays principle (PPP), which holds that the polluter should bear the expenses imposed on society of ensuring that the environment is in an acceptable state.[217] In the *US—Superfund* case, a GATT Panel stated: 'The General Agreement's rules on tax adjustment . . . give the contracting party the possibility to follow the polluter-pays principle, but they do not oblige it to do so'.[218]

Despite their attractiveness, environmental taxes are not yet widespread for several reasons. First, many people are opposed in principle to raising taxes. Second, analysis shows that some environmental taxes would be regressive, falling most heavily on the poor. Third, there is concern that countries employing them would no longer be competitive in the global marketplace, as their industries would suffer in comparison to industries in countries without such taxes. There are, in general, two solutions to this problem. Countries can cooperate and enter into an international agreement that requires all to levy environmental taxes on their producers; or countries that tax their own producers can levy a similar charge on like imported products. Moreover, even if environmental taxes are imposed by international agreement, import taxes may be needed to even out unequal taxation. Charges on imports raise the issue of their consistency with the WTO system and GATT 1994.

There are three different categories of environmental taxes that governments may use. First, taxes can be imposed directly on the sale of a product that has potentially adverse environmental consequences. This category includes deposit-and-return systems, where tax is rebated, and unrebated taxes are levied on environmentally unfriendly products such as cigarettes, certain types of energy, and certain chemicals. Second, the tax can be levied on the use of an environmental resource itself. Examples include charges for the emission of pollutants into the air, discharges into rivers or sewer systems, the congestion of highways, and the use of landfills or hazardous waste disposal facilities. Third, environmental taxes may be imposed on product inputs.

[216] There are four basic types of economic incentives: (1) taxes on charges; (2) transferable pollution permits; (3) deposit-and-return systems; and (4) information strategies. See Stewart, 'Environmental Regulation and International Competitiveness', n. 173 at 2093–4.

[217] On the polluter pays principle, see OECD, Recommendations (C(72)128 on Guiding Principles Concerning International Economic Aspects of Environmental Policies, 11 I.L.M. 1172 (1972); C(74)223 on the Implementation of the *Polluter Pays* Principle, 14 I.L.M. 234 (1974)).

[218] *US—Taxes on Petroleum and Certain Imported Substances*, 17 June 1987, GATT B.I.S.D. (34th Supp.) at 136, para. 5.2.2 (1988) (hereinafter: *US—Superfund*).

Here, two kinds of measures may be distinguished: taxes on inputs that are incorporated physically into the final product (such as chemical feedstock incorporated into a plastic or petroleum product), and taxes on inputs that are completely consumed during production (such as fuel or energy used in the manufacturing of a product).

The GATT distinguishes two principal categories of taxes and charges and submits them to different controls.[219] Article II, which applies to customs duties and import charges, prohibits WTO members from imposing higher charges than those specified in their agreed schedules of concessions. Article III, which applies to internal taxes and charges, requires national treatment. To distinguish between the two, Article II:2(a) provides:

> Nothing in this Article shall prevent any contracting party from imposing *at any time* on the importation of any product:
>
> (a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of an article *from which* the imported product has been manufactured or produced *in whole or in part*. (Emphasis added.)

To further clarify the distinction, an interpretive note (*Ad* Article III) states that '[a]ny internal tax . . . which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time of importation, is nevertheless to be regarded as an internal tax'.

This pattern of GATT regulation makes clear that the distinction between customs charges (Article II) and internal taxes (Article III) is not based on when or where the taxes are levied. Internal taxes can be adjusted at the border or anywhere else in the distribution process. The difference is that internal taxes on imports are equalizing taxes for the purpose of subjecting imports to the equivalent tax regime for domestic like products. Environmental taxes are internal taxes subject to the discipline of Article III, not Article II. Thus, environmental taxes theoretically can be imposed on imports and be adjusted at the border.[220] Which kinds of environmental taxes can be applied to imports depends on the GATT's border tax adjustment rules.

Border tax adjustment (BTA) is the mechanism invented to harmonize the international taxation of products in accordance with the destination principle, which holds that goods should be taxed where they are used or consumed. BTA, which can be traced to the eighteenth century,[221] allows each nation to implement its own regime of domestic taxation while assuring that goods that move in international trade are neither exempt from taxation nor subject to double taxation. BTA allows (1) an internal tax to be imposed on imported products; and (2) the remission of internal taxes on domestic products destined for export.

[219] See generally Ole Kristian Fauchald, *Environmental Taxes and Trade Discrimination* (London: Kluwer Law International, 1998); O'Riordan, ed., *Environmental Taxation* (Earthscan, 1995).

[220] Of course, the requirements of Art. III:2 must be met, which means that imports cannot be charged more than domestic products. In *Japan—Alcoholic Beverages,* however, the Appellate Body held that Art. III:2 embodies two standards. See Appellate Body report, *Japan—Alcoholic Beverages*, 17–25.

[221] See Paul Demaret and Raoul Stewardson, 'Border Tax Adjustments under GATT and EC Law and the General Implications for Environmental Taxes' (1994) *J. World Trade* 28(4), 5, 6–7.

What kinds of domestic taxes are eligible for BTA? From its origin in 1947, the GATT has maintained a fundamental distinction between taxes on products (so-called indirect taxes) and taxes on various forms of income and the ownership of property (so-called direct taxes).[222] Only taxes on products, indirect taxes, are eligible for BTA. For example, as to taxes remitted on export, Article VI:4 provides:

> No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to an anti-dumping or countervailing duty by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes.

Ad Article XVI also makes this point: 'The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy'. In 1970, the GATT Working Party on Border Tax Adjustments made the distinction explicit, agreeing that 'taxes directly levied on products were eligible for tax adjustment', and that 'certain taxes that were not directly levied on products were not eligible for adjustment [such as] social security charges . . . and payroll taxes'.[223]

The economic distinction between direct and indirect taxes was originally based on the idea that indirect taxes generally were passed on to the ultimate consumer, while direct taxes were not. It is now recognized that this distinction is too simplistic; producers absorb many indirect taxes and direct taxes can be passed on in the price of a product.[224] Thus, today the distinction rests on tradition and practicality. It is fundamentally a political compromise that allows equalization of some, but not all, of the differences in internal tax regimes; it is based on administrative practicality in that BTA would be much more difficult to apply to direct taxes; and also is based on the fact that taxes on products can be abused more easily for protectionist purposes.

14.1 Taxes on products

Environmental taxes levied on products are eligible for BTA as long as they are consistent with the national treatment standards of GATT Article III. In the *US—Superfund* case, the Panel made the point that the GATT 'does not distinguish between taxes with different policy purposes'.[225] The GATT requires only that 'like' imported and domestic products be taxed the same. Moreover, there is some flexibility in this national treatment standard. As stated earlier, when products are 'like' only in the sense of being 'substitutable or competitive' with each other, a higher tax on imports is allowable.[226] In addition,

[222] For the history of this distinction, see ibid. 9–12.

[223] *Border Tax Adjustments,* 2 December 1970, GATT B.I.S.D. (18th Supp.) at 97, para. 14 (1972).

[224] Gary Clyde Hufbauer and Joanna Shelton Erb, *Subsidies in International Trade* (Washington DC: Institute for International Economics, 1984) 23.

[225] *US—Superfund* case, para. 5.2.8.

[226] Appellate Body report, *Japan—Alcoholic Beverages.*

in *US—Taxes on Automobiles*,[227] the GATT Panel upheld the validity of US taxes that fell more heavily on imported cars. This ruling seems to justify de facto (but not de jure) discrimination against imports as long as a tax has a valid environmental purpose. This decision is thrown into doubt, however, by the WTO Appellate Body's ruling in *Japan—Alcoholic Beverages* that the purpose of a tax is not a legitimate inquiry under GATT Article III.[228]

A deposit-and-return system of taxes on products is also permissible under GATT rules. In the *Canada Beer* cases,[229] Panels upheld the Canadian deposit-and-return system on beer containers as applied to imports; to meet the national treatment standard, however, the system had to be applied equally without different systems of delivery to points of sale for imported and domestic beer.[230] Thus, GATT norms freely permit BTA with respect to environmental taxes on products.

14.2 Taxes on resource use

Environmental taxes and charges on resource use, such as effluent and emission charges, are not subject to BTA under GATT rules. Such taxes are not on products as such, even though they are incurred in connection with the manufacture of products. The GATT would classify these charges as direct taxes paid out of gross revenues not eligible for BTA.

14.3 Taxes on inputs

The leading case on environmental taxation of physically incorporated inputs is *US—Superfund*, which ruled that taxes on articles used for the manufacture of domestic products may be taken into account in BTA of imported like products. In coming to this conclusion, the Panel relied on an example provided by the 1947 drafting committee to explain the word equivalent in Article II:2(a): 'If a charge is imposed on perfume because it contains alcohol, the charge to be imposed must take into consideration the value of the alcohol and not the value of the perfume, that is to say the value of the content and not the value of the "whole"'.[231] The Panel concluded that the tax met the requirements of Article III:2 because the chemical feedstocks taxed were 'used as materials in the manufacture or production' of the final product. '[T]he tax is imposed on the imported substances because they are produced from chemicals subject to an excise tax in the USA and the tax rate is determined in principle in relation to the amount of these chemicals used and not in relation to the imported substance.'[232] The *US—Superfund* Panel also upheld the method US authorities used in assessing the tax,

[227] *US—Taxes on Automobiles*.

[228] Appellate Body report, *Japan—Alcoholic Beverages*.

[229] *Canada—Import. Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, 22 March 1988, GATT B.IS.D. (35th Supp.) 37 (1989) (hereinafter: *Canada Beer I*); *Canada—Import. Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, 18 February 1992, GATT B.I.S.D. (39th Supp.) at 27 (1993) (hereinafter: *Canada Beer II*).

[230] *Canada Beer II*, para. 5.33.

[231] GATT Doc. EPCT/TAC/PV/26, at 21 (1947), quoted in *US—Superfund*, para. 5.2.7.

[232] *US—Superfund*, para. 5.2.8.

which was to charge 5 per cent of the appraised value of the final product unless the importer furnished the information necessary to determine the exact amount to impose. This method was permissible[233] because the importer, by furnishing proper information, could avoid the penalty tax.

Thus, environmental taxes on inputs that are physically present in some form in the final imported product are properly subject to BTA. This means that BTA can be made, for example, for a tax on chlorofluorocarbons (CFCs) and other ozone-depleting substances with respect to the export/import of refrigerators in which they are incorporated.[234]

15. Border Tax Adjustment in Support of Climate Change Legislation

Climate change is one of the most important environmental issues of our time, and some nations are considering imposing carbon tax surcharges on imported products that will implicate the rules of the WTO. The international regime on climate change, the United Nations Framework Convention on Climate Change (1993) (UNFCC), which has attracted 195 parties, mandates largely unspecified coordinated actions to reduce emissions of carbon dioxide and five additional 'greenhouse gases' into the atmosphere. In 1997, a conference of the parties of the UNFCC adopted the Kyoto Protocol, which mandates specific reductions of greenhouse gas emissions for thirty-five industrialized (Annex I) parties to be achieved by 2012. The Kyoto process, however, was largely unsuccessful. Although the United States was the only Annex I party to reject the Kyoto Protocol, few of the states accepting the Kyoto Protocol have actually achieved their assigned reductions. In addition, non-Annex I parties, which include some of the biggest emitters of greenhouse gases, do not have to achieve binding greenhouse gas reductions. As a result, greenhouse gas emissions into the atmosphere continue to increase.

Despite the widespread non-compliance with UNFCC and Kyoto Protocol mandates, conferences of the parties of both accords are held each year to formulate policies to control greenhouse gas emissions in an effort to achieve a worldwide transition to a low-carbon economy. At a conference of the parties in Copenhagen in 2009, a post-Kyoto regime of climate change was discussed, but the UNFCC parties were unable to agree on a binding agreement. To avert complete failure, a non-binding agreement was tabled, the Copenhagen Accord,[235] which calls upon the parties to the UNFCC to adopt national measures to further reduce greenhouse gas emissions sufficiently to limit the increase of global temperatures to below 2 degrees Celsius and to implement these national targets by 2020. At the time of writing 141 parties have agreed to this Accord and made non-binding pledges to reduce greenhouse gas emissions.[236] Meanwhile,

[233] Ibid. para. 5.3.9.

[234] Panel report, *US—Taxes on Petroleum and Certain Imported Substances*, adopted 17 June 1987, 34th Supp. B.I.S.D. 136 (1988).

[235] FCCC/CP/2009/L.7 (18 December 2009).

[236] <http://www.unfcc.org/home/item>.

work continues to achieve a new binding international agreement to reduce greenhouse gas emissions. In 2011, the UNFCC conference of the parties meeting in Durban, South Africa, resolved to formulate a 'universal legal agreement' on climate change no later than 2015.[237] Thus, many nations are considering new laws to implement greenhouse gas reduction pledges and to prepare for a possible future new binding international agreement. A wide variety of policy instruments are being employed including economic incentive and regulatory measures, subsidies of 'green' energy sources, and price and market mechanisms to internalize the environmental costs of greenhouse gas emissions.

The potential trade implications of such climate change measures are manifold, including the possible adoption of reduced tariffs for 'green' products, possible infringements of WTO subsidy rules, and the development of new international technical standards to promote the use of climate-friendly products and technologies.[238] However, the most important way that trade may be affected by climate change laws is the possible adoption of new carbon-based taxes or charges on imported products. A WTO member that adopts a law requiring domestic industries to limit their greenhouse gas emissions may adopt a scheme for carbon-based charges on imported products. The declared purpose of such charges is to prevent carbon 'leakage', the undermining of domestic reduction measures by countries that may not mandate similar reductions, and the equalization of competitive disadvantages caused by the implementation of domestic climate change measures.[239]

Two principal types of domestic laws are likely to impose corresponding carbon-based import charges on imported products:

(1) *Carbon taxes.* Domestic products would pay a tax based upon the amount of carbon emitted into the atmosphere in the product's production. This scheme would levy an equalization tax on imports of like products.

(2) *Cap-and-trade*. This scheme requires an upper limit to be set on greenhouse gas emissions and emission allowances are distributed to industries. Individual emitters may legally emit greenhouse gases up to the allowances they possess. Any allowances they do not use may be sold to buyers that need additional allowances. This method creates a market and trading of emission allowances. Importers would be required to purchase international allowances, paying set or variable charges.[240]

[237] See <http://www.unfcc.org/durbanconference>.

[238] Ludivine Tamiotti and Vesile Kulacoglu, 'National Climate Change Mitigation Measures and Their Implications for the Multinational Trading System: Key Findings of the WTO/UNEP Report on Trade and Climate Change' (2009) *J. of World Trade* 43, 1115.

[239] Ibid. 1126–30.

[240] A cap-and-trade bill of this type was passed by the US House of Representatives in 2009, but the proposal did not become law because of inaction by the US Senate. See the American Clean Energy and Security Act, HR 2454, US House of Representatives, 111th Congress (2009–10).

What are the implications of such taxes and charges under the rules of the WTO? No WTO case has considered this question so the answers are uncertain,[241] but we offer our opinion here. On the one hand, we believe that a tax on imports calibrated to be equal to the domestic carbon tax on like products and collected at the border according to border tax adjustment principles would pass WTO muster. On the other hand, we believe that an import charge system designed to offset leakage in a cap-and-trade system would be vulnerable to attack under applicable WTO rules. We consider these in turn.

15.1 A domestic carbon tax and border tax adjustment

Country A may impose an energy-product tax on imports collected at the border based upon the principle of border tax adjustment (BTA) that is equivalent in value to a domestic energy tax on like products. Such an import charge can be calibrated to pass the test of GATT Article III:2, first sentence, which permits internal taxes to be levied on imported products as long as they are not taxed 'in excess' of the taxes levied upon like domestic products. If this is the case, GATT Article II:2(a) permits BTA to collect the taxes on imported products at the border. BTA facilitates the collection of internal taxes on imports based on the idea that products should be taxed in the territory of their consumption—the 'destination principle'. BTA is carried out to collect the domestically equivalent taxes on imports while rebating domestic taxes on products that are exported.

The key to a successful BTA climate change tax scheme is to make sure that, although based on energy or carbon inputs, the tax is levied on *products*. The reason for this is to comply with the conclusions reached by the 1970 report of the GATT Working Party on BTAs,[242] which stated unequivocally that indirect taxes—taxes on products—are eligible for BTA, while direct taxes—taxes such as social security and payroll charges—are not. We note that the Working Party reported a difference of opinion on '*taxes occultes*'—taxes on material and services used in the transportation and production of other taxable goods.[243] An energy tax would be such a '*tax occulte*', so that BTA for energy taxes as such remains questionable. But we believe that a tax on a product based upon energy input or carbon factors would appear to be a product tax eligible for BTA.

There remains a concern because energy as an input to a product does not physically remain, but is consumed in the process of production. GATT Article III does not speak to this issue, and GATT Article II:2(a) is equivocal: this provision allows a tax on inputs 'from which the imported product has been manufactured or produced'. This wording might be interpreted to include or to exclude inputs to a product such as energy that disappears in the course of production. Although the wording is ambiguous, we think

[241] For a more detailed analysis, see Gary Clyde Hufbauer, Steve Charnovitz, and Jisun Kim, *Global Warming and the World Trading System* (Washington, DC: Peterson Institute for International Economics, 2009).

[242] Border Tax Adjustments, Report adopted on 2 December 1970, L/3464, B.I.S.D. 18S/97-109.

[243] Ibid. paras. 15–16.

that it should be interpreted to cover energy or carbon expenditure inputs to products. A major reason for this conclusion is that on the *export* side there is clear authority in favour of BTA for energy or inputs consumed in the production process.

With regard to the legality of BTA and remission of domestic taxes on exported products, the 1994 WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) distinguishes between countervailable export subsidies on the one hand and permissible remissions of indirect (product) taxes on the other by means of providing an Illustrative List of Export Subsidies.[244] Paragraph (g) of this Illustrative List states that there is an export subsidy if there is 'any exemption or remission, in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.' Footnote 58 to the Illustrative List defines 'indirect taxes' as 'sales, excise, turnover, inventory, and equipment taxes, border taxes, and all other taxes other than direct taxes and import charges.' The purpose of paragraph (g) was to clarify that value-added taxes (VAT) may be remitted on export. However, the Illustrative List paragraph (h) also makes clear that remissions of 'prior-stage cumulative indirect taxes on goods or services' used in the production of products are likewise not export subsidies as long as the remissions are not in excess of those levied in the production of like products when sold for domestic consumption. And paragraph (i) of the Illustrative List extends this treatment to inputs to products consumed in the production process of exported products. Annex II of the SCM Agreement furthermore contains Guidelines on the Consumption of Inputs in the Production Process and here such inputs are specifically defined as 'inputs physically incorporated, *energy, fuels and oil* used in the production process'.[245]

Thus on the export side it is clear that remissions of all forms of energy taxes on products are permissible if they are not in excess of the similar taxes levied, and the remissions can include prior-stage taxes and taxes on inputs consumed in the production process of the products in question. While on the import side there is some ambiguity, the WTO should interpret GATT Article II:2(a) to allow symmetry in BTA with respect to imports and exports. To interpret Article II:2(a) to prohibit BTA on the import side, while BTA is permissible on the export side would be nonsensical.

The interpretation that GATT Article II:2(a) permits both the collection and remission of energy or carbon-based charges on products in connection with BTA, is supported by the rules on interpretation of the VCLT, which the WTO Appellate Body has employed in myriad cases to resolve interpretative ambiguities. VCLT Article 31 requires that a treaty be interpreted in good faith in accordance with its terms in their context and in the light of the treaty's object and purpose. The provisions of the WTO SCM Agreement that clearly permit remission of energy input taxes and BTA on the export side are key parts of the context of GATT Article II:2(a). Thus, interpreting Article II:2(a) in its context as required by VCLT Article 31, requires the interpretation that border collection of energy input charges on imported products that otherwise are consistent with GATT Article III:2, are permitted using BTA.

[244] SCM Agreement, Annex I. [245] SCM Agreement, Annex II, fn. 61, emphasis added.

15.2 Cap-and-trade laws and energy taxes and charges

The second type of border measure that may be levied on imports to supplement domestic climate change legislation is the requirement that importers pay a charge or purchase an 'international reserve allowance' to mitigate the greenhouse gas emissions that were created in the imported products' production. The amount of such a charge or the quantity of allowances required for each imported product would be determined administratively using some formula or criteria. Flexibility could be injected into such a system by creating a market for international reserve allowances and allowing importers to purchase the number of allowances needed to import a given kind and quantity of products. Under such a system, however, imports would be barred unless the importer proves it has purchased the required quantity of allowances.

This system of climate change border charges would violate many WTO rules. No doubt imports from certain WTO members would enjoy exemptions on the ground that their domestic climate change laws were comparable or sufficient to minimize greenhouse gas emissions. Such exemptions would be prima facie violations of GATT Article I, the MFN principle. Moreover, such a system would also violate GATT Article II:1(b), which prohibits 'duties and charges' other than those contained in the member's GATT schedule. Potential additional violations might include GATT Article III:2 if the charge is found to be a tax and it is not exactly equivalent to the corresponding taxes levied on domestic like products; and GATT Article III:4 if the system is found to be a regulatory system on imported products. Thus the only hope of justifying such a system would be GATT Article XX(b) and (g), respectively, the general exceptions for human, animal, and plant life and health, and to conserve exhaustible natural resources. The crucial analysis under Article XX(b) would be the 'necessary' element, and under XX(g) the elements of conservation, exhaustible natural resource, and the 'in conjunction with' domestic measures requirement. We think that the climate change international allowances system might pass either or both Articles XX(b) and (g), but would founder on the Article XX chapeau, which prohibits arbitrary or unjustified discrimination and disguised obstacles to international trade. The application of the chapeau to such a system would very much depend on the administrative details of the cap-and-trade allowances or charges system and cannot be undertaken here. Suffice it to say that the perils of such a system are obvious as well as the dangers of misusing such a system for protectionism and for the disruption of international trade. Thus, a tax system is far preferable to cap-and-trade and would be much easier to fold into the rules of the multilateral trading system.

15.3 Climate change and the TBT Agreement

The TBT Agreement may play an important role in adjusting international trade in goods to protecting the earth's climate from anthropomorphic changes. The TBT Agreement governs technical regulations, which are mandatory, and product standards, which are voluntary, as well as labelling schemes attached to products. The definition of technical regulations and standards also makes clear that both may specify

requirements of process and production methods as well as product characteristics. Thus, energy-related standards may be adopted for products in international trade that would be enforced by national authorities at the border. But the national standards would have to pass the tests of the TBT Agreement, particularly the requirements of TBT Article 2. Most importantly, mandatory or voluntary climate change technical regulations or standards must be non-discriminatory and must not be prepared or applied with the intention or effect of creating unnecessary obstacles to trade.[246] National standards must additionally not be 'more trade-restrictive than necessary to fulfill a legitimate objective,' but harmonization of international technical regulations and standards and especially the adoption of international standards is clearly preferable to avoid violations.[247] Protection of climate and international trade can be best reconciled under the criteria of the TBT Agreement by charging appropriate international standard-setting organizations with the development of international technical requirements and standards for the most important products traded internationally. In this way, energy efficiency standards can be adopted and enforced by WTO members in conformity with existing WTO rules.

16. Conclusions

After a difficult start, the WTO has made excellent progress in reconciling many important tensions and conflicts between international trade and protection of the environment. This new accommodation that has occurred since 1995 is almost wholly the work of the Appellate Body. Now it would appear time for other institutions, such as the CTE and the Ministerial Conference, to address additional aspects of the trade and environment agenda.

Two further aspects bear mentioning that have not yet been addressed. First, the matter of environmental regulations and their effect on market access problems of developing countries, one of the tasks given to the CTE in 1995, has not received enough attention. This needs to be corrected.

A second area that has been overlooked is subsidies that have the effect of impairing environmental quality. Fishing subsidies are now on the negotiating agenda; this is long overdue. The WTO should tackle other subsidy programmes as well, such as the US sugar subsidy programme that encourages sugar farming in south Florida to the great detriment of Everglades National Park.[248]

We should accept, however, that there will be no grand resolution of the trade and environment conflict. Rather, the process of accommodation will be ongoing, demanding continual concern at the WTO as work proceeds on the built-in agenda of the Uruguay Round as well as possible new trade and investment agreements. New trade and environment conflicts will inevitably occur, especially in the areas of conservation of natural resources, animal cruelty, food safety, intellectual property, trade in services, and subsidies. The process of reconciling trade and the environment will remain an ongoing concern.

[246] TBT Agreement, Art. 2.1 and 2.2. [247] TBT Agreement Art. 2.4.

[248] Aaron Schwaback, 'How Free Trade Can Save the Everglades' (2002) *Geo. Int'l Envtl. L. Rev.* 14, 301.

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Trade and Investment

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1. Trade and Investment in the GATT/WTO: From High Hopes to Modest Steps

1.1 High hopes in Havana

International trade and investment are closely intertwined, as investment may substitute or complement trade flows: Market access restrictions may be circumvented through increased local presence, requiring investment. On the other hand, successful market access may very well entice foreign investment by exporters to stabilize and develop the acquired position in the marketplace. This may lead to a further increase of international trade.[1] The Havana Charter of the International Trade Organization (ITO) of March 1948[2] recognized this: Its drafters included separate provisions on trade and investment. In fact, Article 12 of the Havana

[1] See WTO Doc. WT/WGTI/W/7, WTO Working Group on the Relationship between Trade and Investment, The Relationship between Trade and Foreign Direct Investment, 18 September 1997.

[2] See United Nations Conference on Trade and Employment, Final Act and Related Documents (1948), reprinted, for example, at <http://www.wto.org/english/docs_e/legal_e/havana_e.pdf>.

Charter[3]—the core provision dealing with investment—may have contributed to the US Congress rejecting the comprehensive post-Second World War system of global economic governance that had been devised under American leadership since 1942, culminating in the Bretton Woods Conference. The business of investment protection was left to bilateral investment treaties (BITs) that started their remarkable career as one of the most successful types of international agreements with the German-Pakistani BIT of 1959.[4] Slightly ahead of the curve, a 1955 resolution on 'International Investment for Economic Development'[5] by the GATT contracting parties recognized that an increase in investment capital flows, particularly into developing countries, would help attain the objectives of the GATT. It recommended

[3] cf. Art. 12 of the Havana Charter on International Investment for Economic Development and Reconstruction:

1. The Members recognize that:
   - (a) international investment, both public and private, can be of great value in promoting economic development and reconstruction, and consequent social progress;
   - (b) the international flow of capital will be stimulated to the extent that Members afford nationals of other countries opportunities for investment and security for existing and future investments;
   - (c) without prejudice to existing international agreements to which Members are parties, a Member has the right:
     - (i) to take any appropriate safeguards necessary to ensure that foreign investment is not used as a basis for interference in its internal affairs or national policies;
     - (ii) to determine whether and, to what extent and upon what terms it will allow future foreign investment;
     - (iii) to prescribe and give effect on just terms to requirements as to the ownership of existing and future investments;
     - (iv) to prescribe and give effect to other reasonable requirements with respect to existing and future investments;
   - (d) the interests of Members whose nationals are in a position to provide capital for international investment and of Members who desire to obtain the use of such capital to promote their economic development or reconstruction may be promoted if such Members enter into bilateral or multilateral agreements relating to the opportunities and security for investment which the Members are prepared to offer and any limitations which they are prepared to accept of the rights referred to in sub-paragraph (c).
2. Members therefore undertake:
   - (a) subject to the provisions of paragraph 1(c) and to any agreements entered into under paragraph 1(d),
     - (i) to provide reasonable opportunities for investments acceptable to them and adequate security for existing and future investments, and
     - (ii) to give due regard to the desirability of avoiding discrimination as between foreign investments;
   - (b) upon the request of any Member and without prejudice to existing international agreements to which Members are parties, to enter into consultation or to participate in negotiations directed to the conclusion, if mutually acceptable, of an agreement of the kind referred to in paragraph 1(d).
3. Members shall promote co-operation between national and foreign enterprises or investors for the purpose of fostering economic development or reconstruction in came where such co-operation appears to the Members concerned to be appropriate.

See on the Havana Charter, Clair Wilcox, *A Charter for World Trade* (Macmillan, 1949); William Adams Brown, *The United States and the Restoration of World Trade* (Brookings Institution, 1950); Georg Schwarzenberger, 'The Principles and Standards of International Economic Law' (1966) *Recueil des Cours*, 117, 1–98.

[4] cf. <http://www.iisd.org/pdf/2006/investment_pakistan_germany.pdf>.

[5] International Investment for Economic Development, 4 March 1955, GATT B.I.S.D. (3rd Supp.) at 49–51 (1955).

that parties enter into negotiations towards the conclusion of bilateral and multilateral agreements on, inter alia, the security of foreign investment and the transfer of earnings derived from investment. However, a proposal to insert rules on establishment in the GATT was not accepted.[6] Thus, apart from this rather modest support, the GATT was not the place to turn to for finding legal rules concerning investment protection and regulation.

1.2 The FIRA report

Then came the 1984 report *Canada—FIRA*.[7] There, the Panel had to address the US complaint that certain types of undertakings required from foreign investors as a condition for the approval of investment by Canadian authorities were in violation of the GATT. Canada had requested, as a condition for welcoming foreign direct investment (FDI), the purchase of certain products from domestic sources ('local content requirements') and required a percentage of the output to be exported ('export performance requirements'). In its report, the Panel took the view that the former measures (the local content requirements) were inconsistent with GATT Article III:4.

As foreign products having legally obtained access to the Canadian market did not receive similar beneficial treatment, the Panel rightly assumed a violation of GATT Article III:4. In contrast, the export performance requirements were not viewed as being inconsistent with GATT obligations, notably GATT Article XI.[8] The Panel emphasized that while the GATT did not purport to regulate Canada's foreign investment policy, it still constituted a benchmark for any trade-affecting measures by a GATT contracting party, even if it had been taken with the sole purpose of enacting foreign investment legislation (and thus not with a view to regulating trade).

The *FIRA* jurisprudence has been taken up and developed by WTO Panels and the Appellate Body: In *China—Auto Parts*, the Appellate Body upheld the Panel's findings that China's imposing an 25 per cent additional charge on imported auto parts violated GATT Article III:2, because that charge was not imposed on like domestic auto parts.[9] It further found GATT Article III:4 to be violated, as China accorded imported parts less favourable treatment than *like* domestic auto parts, in particular due to subjecting only imported parts to certain particularly burdensome administrative procedures.[10]

[6] GATT Doc. W.9/198, Review Working Party IV on Organizational and Functional Questions, Draft Report of Working Party IV, 15 February 1955, para. 14. cf. Mark Koulen, 'Foreign Investment in the WTO' in Eva Nieuwenhuys and Marcel Brus, eds., *Multilateral Regulations of Investment* (Kluwer, 2001) 181–203, 183.

[7] GATT Panel report, *Canada—Administration of the Foreign Investment Review Act*, L/5504, adopted 7 February 1984, B.I.S.D. 30S/140; cf. Michael Hahn, 'WTO Rules and Obligations Related to Investment', in Marc Bungenberg, Joern Griebel, Stephan Hobe, and August Reinisch, eds., *International Investment Law, A Handbook* (Oxford: Hart, 2015) 653 *et seq.*

[8] Art. XI:1 (General Elimination of Quantitative Restrictions) reads: 'No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.'

[9] *China—Auto Parts* (Appellate Body), para. 186.

[10] Ibid. paras. 196, 197.

In *India—Autos*,[11] the Panel had to examine whether India's local content requirement and its 'trade balancing requirement', pursuant to which imports value had to be less or equal to exports values, were compatible with India's obligations under the GATT. In the Panel's view, the measure violated GATT Article III:4 as the local content affected the conditions of competition in the Indian market to the detriment of imported car parts and components.[12] With regard to India's trade balancing requirement, the Panel was of the view that it limited the amount of imports in relation to an export commitment; this was rightly viewed as a restriction on importation within the meaning of Article XI:1.[13] As the measures in question burdened the purchasers of imported components on the Indian market with an additional obligation to export cars or components, the Panel was of the opinion that the measure created a 'disincentive' to the purchase of imported products.[14] This, of course, is treatment less favourable to imported products than to like domestic products, and hence incompatible with Article III:4.[15]

In a nutshell, the *FIRA* report and its jurisprudential progeny highlight the relevance of WTO rules for investors. Indeed, the nexus between trade and investment had become clear by the mid-1980s. The new round of multilateral trade negotiations (what became the Uruguay Round) was about to start; however, a proposal for a comprehensive agreement on investment by the United States[16] did not receive the necessary endorsement of the contracting parties. Nevertheless, many of the Uruguay Round agreements contain a number of highly relevant provisions dealing with investment-related legal parameters. In this chapter, we will attempt to give an overview of those provisions.

1.3 The failed Multilateral Agreement on Investment (MAI)

From 1992 onwards, a serious effort was made to negotiate a comprehensive treaty on investment, known as the Multilateral Agreement on Investment (MAI),[17] with the OECD Investment Committee as incubator of the preparatory work.[18] The MAI was supposed to become the first truly global agreement on liberalization of investment.

[11] *India—Autos* (Panel); this is the last of a series of disputes concerning TRIMs with regard to the car industry; see in particular, *Indonesia—Autos* (Panel).

[12] *India—Autos* (Panel), paras. 7.204, 7.205. [13] Ibid. paras. 7.252, 7.253.

[14] Ibid. para. 7.308. [15] Ibid. para. 7.309.

[16] GATT Doc. PREP.COM (86)/W/35, Preparatory Committee, 'Investment', 11 June 1986; according to the United States, '[i]t was submitted in precisely the same spirit as the proposal on services: if the GATT were to reflect and be responsive to the world trade system of the future, the new round must address the issues raised for trade by investment problems', GATT Doc. PREP.COM(86)SR/8, Preparatory Committee, 'Record of Discussions', 13 August 1986, para. 3. cf. also Terence Stewart, *The GATT Uruguay Round: A Negotiating History*, vol. II (Kluwer, 1993) 2061 *et seq*.

[17] Transaction cost-related arguments would support the conclusion of such an agreement. On the economics of a multilateral agreement, see Asaf Razin, 'Social Benefits and Losses from FDI' in Ito Takatoshi and Anne Krueger, eds., *Regional and Global Capital Flows* (University of Chicago Press, 2001) 310ff.

[18] The twenty-nine OECD members as well as the Commission of the European Community participated in the negotiations. Eight non-OECD members participated as observers: Argentina, Brazil, Chile, Estonia, Hong Kong, China, Latvia, Lithuania, and the Slovak Republic. Other non-OECD members were informed on a regular basis about the status and substance of the negotiations. The negotiators felt the time was ripe for a global framework for investment mainly because foreign direct investment (FDI) grew fourteen times between 1973 and 1996 (from $25 to $350 billion), a great deal faster than growth in international trade.

The negotiations formally began in September 1995, continued until April 1998, and extended into the fall of 1998. The mandate for the negotiations was to achieve a multilateral framework for investment with high standards of investment liberalization and protection. Moreover, negotiators aimed at providing an effective dispute settlement system that would be accessible to both non-OECD members and OECD members.

The coverage of the MAI was supposed to be quite broad: FDI, portfolio investment, and rights under contract formed part of its subject matter. Unlike the regime envisaged by most bilateral investment treaties of the time, the MAI purported to cover the pre-establishment phase as well.[19] MAI negotiators envisaged three pillars: investment liberalization, investment protection, and dispute settlement. With respect to the first and the second pillars, the MAI advances the principles of non-discrimination (national treatment (NT) and most favoured nation (MFN)). With respect to the third pillar, the MAI contained provisions on cross-border transfer of funds, fair and equitable treatment, and the standard of compensation in case of expropriation.

The multilateral investment negotiations, however, provoked a series of negative reactions. Early on, developing country members disputed its global character because they did not participate in the negotiations. Some developed countries also became reluctant, as they felt that concerns such as the environment or the status of cultural industries were not adequately addressed by the draft MAI. Eventually, the project was abandoned in late 1998; efforts to revitalize it have so far proven unsuccessful.

The debate over the MAI focused on several issues: first, despite the recognized nexus between investment and job creation, it was feared that the MAI would allow (foreign) investors to exert too much influence on governments and dominate economic sectors, especially in developing countries; second, there were concerns that investment liberalization would increase the consequences of potential future economic crises, as it was feared that overseas investors would ‘take their money and run’ at early stages of economic downturns. Empirical research seems to indicate that the untimely withdrawal of foreign investment is limited to portfolio investment (such as the buying of company shares as a financial instrument), whereas investors aiming at controlling companies through FDI have no worse track record with regard to disinvestment than local investors. For instance, during both the Mexican peso devaluation of 1994–95 and the Asian economic crisis of 1997–98, FDI seems to have been largely stable.[20] A third reason for NGOs opposing investment liberalization was the concern that multilateral companies would prefer to invest in low-wage countries with inadequate labour standards, thus creating an incentive for other countries to adapt and start a race to the bottom. Similarly, NGOs claimed that investors would preferentially select countries with low environmental standards and use their influence to protect the status quo in the post-establishment phase, thus blocking desirable societal

[19] cf. Giorgio Sacerdotti, ‘Bilateral Treaties and Multilateral Instruments on Investment Protection’ (1997) *Recueil des cours*, 269; Pierre Sauvé and Christopher Wilkie, ‘Investment Liberalization in GATS’ in Pierre Sauvé and Robert M. Stern, eds., *GATS 2000: New Directions in Services Trade Liberalization* (Brookings, 2000) 331–63.

[20] See Asaf Razin, ‘The Contribution of FDI flows to Domestic Investment in Capacity, and Vice Versa’ in Ito Takatoshi and Andrew K. Rose, eds., *Growth and Productivity in East Asia, NBER* (University of Chicago Press, 2004) 149–76.

developments in the developing world.[21] As evidence, they cited the impact of *NAFTA*, Chapter 11, which has been perceived as being used by investors to stifle more stringent environmental standards.[22]

As a result, a chapter on the impact of current WTO law can only introduce to the different existing legal instruments that massively influence investors' decisions to engage in a host country (or not): most notably, the GATS, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs),[23] and the Agreement on Government Procurement (GPA) impose obligations on members with respect to entry and treatment of foreign (natural and juridical) persons and the protection of certain economic interest (discussed in more depth in section 3 *et seq.*). Others, most notably the Agreement on Trade-Related Investment Measures (TRIMs, discussed in more depth in section 2), and the Agreement on Subsidies and Countervailing Measures (SCM) impact investments more indirectly by regulating investment-related measures, such as the granting of incentives for investments or restricting the operations of overseas investors.

2. The Agreement on Trade-Related Investment Measures (TRIMs)

2.1 The scope of TRIMs

Aiming to contain 'trade restrictive and distorting effects of investment measures' highlighted in the *FIRA* case, the TRIMs[24] engages 'to promote the expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners, particularly developing country members, while ensuring free competition'.[25] Due to the failure of the MAI, TRIMs may be described as the first, albeit modest, and so far the only, multilateral agreement to discipline government-imposed investment restrictions.

The usual mix of investment incentives, such as tax breaks and state aid, is not specifically the subject of TRIMs which explicitly restates substantive GATT ground rules.[26] TRIMs' investment impact is largely restricted to the explicit recognition that

[21] See Environmentalists' Letter on MAI, 13 February 1997, reprinted in *Inside U.S.Trade*, 21 February 1997, at 12–13.

[22] See the NAFTA decision on *Metaclad Corp. v Mexico* (2001) 40 I.L.M. 36, awarding damages when a company's investment in a hazardous waste treatment facility approved by the federal government of Mexico was blocked by local Mexican authorities.

[23] The protection of technology removes insecurity for foreign investors and promotes the transfer of technology between countries. By the same token, the Agreement on Subsidies and Countervailing Measures (SCM), through its disciplines on double taxation and on subsidies in general, affects investment flows.

[24] TRIMs is an integral part of the WTO Agreement, which applies to investment measures related to trade in goods (TRIMs Art.1); cf. *Indonesia—Autos* (Panel), paras. 14.62–14.92.

[25] The Preamble of the TRIMs Agreement.

[26] *Indonesia—Certain Measures Affecting the Automobile Industry* (Panel), paras. 14.58–14.92, 14.73: 'We note that the use of the broad term "investment measures" indicates that the TRIMs Agreement is not limited to measures taken specifically in regard to *foreign* investment.... [N]othing in the TRIMs Agreement suggests that the nationality of the ownership of enterprises subject to a particular measure is an

certain investment measures distort trade and that these distortions are incompatible with the GATT as they may affect the volume and the composition of trade. Local content requirements, held to have 'trade restrictive and distorting effects of investment measures' by the *FIRA* Panel, are a protectionist advantage for domestically produced 'like products', and thus, a violation of the NT obligation. In much the same fashion, the linkage between the quantity of allowed imports of goods to export performance is outlawed. The TRIMs central provision, its Article 2, reads:

> Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.

An illustrative list, attached in the Annex specifies:

1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:
   (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or
   (b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.
2. TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which restrict:
   (a) the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;
   (b) the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or
   (c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.

element in deciding whether that measure is covered by the Agreement. We therefore find without textual support in the TRIMs Agreement the argument that since the TRIMs Agreement is basically designed to govern and provide a level playing field for foreign investment, measures relating to internal taxes or subsidies cannot be construed to be a trade-related investment measure. We recall in this context that internal tax advantages or subsidies are only one of many types of advantages which may be tied to a local content requirement which is a principal focus of the TRIMs Agreement. The TRIMs Agreement is not concerned with subsidies and internal taxes as such but rather with local content requirements, compliance with which may be encouraged through providing any type of advantage. Nor, in any case, do we see why an internal measure would necessarily not govern the treatment of foreign investment.'

Hence, TRIMs Article 2.1 prohibits WTO members from applying any investment measure that is inconsistent with GATT Article III (National Treatment) or GATT Article XI (prohibition on quotas).[27] The jurisprudence on GATT Articles III and XI tends to interpret the two provisions in a way that preserves its *effet utile*.[28]

Despite this state of play, it is submitted that the TRIMs adds some value to the multilateral trade regime: by identifying specific types of trade-related investment measures as being per se inconsistent with GATT Article III or XI. The Illustrative List, as the *India—Autos* Panel held, indeed 'provides additional guidance as to the identification of certain measures considered to be inconsistent with Articles III:4 and XI:1 of the GATT 1994'.[29]

If a measure falls under the Illustrative List, it will be found to be WTO-incompatible:

> An examination of whether . . . [the] measures [in question] are covered by Item (1) of the Illustrative List . . . will not only indicate whether they are trade-related but also whether they are inconsistent with Article III:4 and thus in violation of Article 2.1 of the TRIMs Agreement.[30]

Pursuant to the GATT, WTO members have to notify measures of general applicability (GATT Article X). Arguably, most measures covered by TRIMs are of general applicability. GATT Article X, however, leaves substantial discretion to WTO members to this effect. TRIMs reduces the scope for discretion by obliging them to notify all TRIMs.

2.2 TRIMs and multilateral agreements on trade

In the event of a conflict between provisions of the GATT and TRIMs, the provisions of TRIMs would prevail.[31] The term 'conflict' is not defined any further. Panels have relied on the concept of *lex specialis*: A state measure which—in principle—is subject to two different agreements, should always be submitted to the one which regulates the issue at stake more specifically.[32] Somewhat counterintuitively, there is no agreement across Panels as to which of the two (GATT or TRIMs) is the more specific agreement. *Indonesia—Autos* was the first panel to analyse the issue:

> [It] first examine[d] the claims under the TRIMs Agreement since the TRIMs Agreement is more specific than Article III:4 [of the GATT] as far as the claims under consideration are concerned.[33]

[27] *Canada—Wheat* (Panel), paras. 6.376–6.382; *Canada—Autos* (Panel), para. 10.150; *Indonesia—Autos* (Panel), paras. 14.61–14.92.

[28] GATT Panel report, *Canada—Administration of the Foreign Investment Review Act*, L/5504, adopted 7 February 1984, B.I.S.D. 30S/140; GATT Panel report, *Japan—Trade in Semi-Conductors*, L/6309, adopted 4 May 1988, B.I.S.D. 35S/116.

[29] *India—Autos* (Panel), para. 7.157.

[30] *Indonesia—Autos* (Panel), para. 14.83.

[31] According to the General Interpretive Note to Annex 1A of the WTO Agreement, when a 'conflict' exists between a provision of the GATT and a provision of another agreement in Annex 1A (such as TRIMs), the provision of the other agreement shall prevail to the extent of the conflict.

[32] *EC—Bananas III* (Appellate Body), para. 204.

[33] *Indonesia—Autos* (Panel), para. 14.63.

The *Canada—Autos* Panel agreed 'that a claim should be examined first under the agreement which is the most specific with respect to that claim',[34] but distanced itself from the result of *Indonesia—Autos*. In its view, TRIMs could not be

> properly characterized as being more specific than Article III:4 in respect of the claims raised by the complainants in the present case.[35]

The Panel analysed the measures in question under the GATT because the parties disagreed:

> not only on whether the measures at issue can be considered to be "trade-related investment measures", but also on whether the Canadian value-added requirements and ratio requirements are explicitly covered by the Illustrative List annexed to the TRIMs Agreement.[36]

The *India—Autos* Panel took a similar approach.[37] It noted

> that it is permitted to apply judicial economy in considering matters before it, so that "a panel need only address those claims which must be addressed in order to resolve the matter in issue in the dispute".[38]

After finding that the measures in question violated GATT Article III:4 and Article XI:1, the Panel applied the principle of judicial economy and concluded that it was not necessary to analyse the measures under TRIMs.[39] The *EC—Bananas III* Panel report, after finding that the measure in question was inconsistent with GATT Article III:4, decided that it was not necessary to examine whether the measure was also inconsistent with TRIMs Article 2.1 because:

> with the exception of its transition provisions, the TRIMs Agreement essentially interprets and clarifies the provisions of Article III (and also Article XI) where trade-related investment measures are concerned. Thus the TRIMs Agreement does not add to or subtract from those GATT obligations, although it clarifies that Article III:4 may cover investment-related matters.[40]

[34] *Canada—Autos* (Panel), para. 10.63. [35] Ibid. [36] Ibid.

[37] *India—Autos* (Panel), para. 7.157 *et seq.*; the Panel stated that '[as] a general matter, even if there was some guiding principle to the effect that a specific covered agreement might appropriately be examined before a general one where both may apply to the same measure, it might be difficult to characterize the TRIMs Agreement as necessarily more "specific" than the relevant GATT provisions', para. 7.157. The Panel analysed the measures in question under the GATT first, partly because India, the responding party, encouraged the Panel to refrain from analysing the measures under the TRIMs. The order of analysis should not affect the outcome but, as the Panel implicitly recognized, it may have an impact on the potential for Panels to apply the principle of judicial economy.

[38] Ibid., para. 7.152 [footnote omitted]. In *Indonesia—Autos*, the Panel, after finding that the measures in question were inconsistent with TRIMs Art. 2.1, decided that, based on the principle of judicial economy, it did not have to address the claims under GATT Art. III:4. The Panel described the principle of judicial economy as one in which 'a panel only has to address the claims that must be addressed to resolve a dispute or which may help a losing party in bringing its measures into conformity with the WTO Agreement', *Indonesia—Autos* (Panel), para. 14.93.

[39] *India—Autos* (Panel), para. 7.324.

[40] *EC—Bananas III* (Panel), para. 7.185 [footnote omitted]. Subsequently, *Canada—Autos* (Panel), para. 10.91, found that the measures in question were inconsistent with GATT Art. III:4, and decided that it was not necessary to determine whether the measures were also inconsistent with TRIMs Art. 2.1. See also

With regard to the relationship between the SCM Agreement and the TRIMs, the *Indonesia—Autos* Panel examined whether there was conflict between the two agreements, recalling that the General Interpretive Note was not applicable to the relationship between the TRIMs and the SCM.[41] It did, however, use a narrow definition of the term 'conflict' to arrive at its final judgment that there was 'no general conflict between the SCM Agreement and the TRIMs Agreement'.[42] Applying the principle of effective treaty interpretation, a measure coming under both TRIMs and the SCM, should be first reviewed under the latter, because the SCM reflects a more elaborate legal regime dealing with subsidies.

2.3 Substantive provisions

2.3.1 TRIMs inconsistent with GATT Article III

The TRIMs prohibits WTO members from applying measures that are inconsistent with GATT Article III (TRIMs Article 2.1). The Illustrative List annexed to TRIMs sets out two categories of GATT Article III:4-inconsistent measures: local content requirements and the linkage between the right to import goods and export performance.

In *Indonesia—Autos*, the Panel ruled on the legality of an Indonesian 'car programme' linking tax benefits for cars manufactured in Indonesia to local content requirements, and linking customs duty benefits for imported components of cars manufactured in Indonesia to similar local content requirements. The Panel found that these local content requirements were investment measures, because they had a significant impact on investment in the automotive sector.[43] The Panel also found that compliance with the requirements for the purchase and use of products of domestic origin was necessary to obtain the tax and customs duty benefits and that such benefits were advantages within the meaning of the Illustrative List.[44] As a result, the Panel ruled that the local content requirements imposed by Indonesia violated TRIMs.[45]

2.3.2 TRIMs inconsistent with GATT Article XI

TRIMs also prohibits WTO members from applying trade-related investment measures that are inconsistent with GATT Article XI (TRIMs Article 2.1). The Illustrative List annexed to TRIMs establishes three categories of measures, which share as a common trait that they establish all (albeit potentially in varying degree) export-related performance requirements. The *India—Autos* litigation involved the review of an Indian trade balancing measure: the import (by domestic car manufacturers) of

Canada—Renewable Energy/Feed-In Tariff Program (Panels), para. 7.166, according to which the measures in question (FIT Program) were 'TRIMs falling within the scope of Paragraph 1(a) of the Illustrative List, and that in the light of Article 2.2 and the chapeau to Paragraph 1(a) of the Illustrative List, they are inconsistent with Article III:4 of the GATT 1994, and thereby also inconsistent with Article 2.1. of the TRIMs Agreement'.

[41] *Indonesia—Autos* (Panel), para. 14.28, fn. 650. [42] Ibid. para. 14.36.
[43] Ibid. para. 14.28, fn. 650. [44] Ibid. paras. 14.89–14.91.
[45] Ibid. para. 14.91.

parts and components necessary for the production of cars was conditioned on a certain FOB (free on board) value of exports of cars and components over the same period; if the statutory thresholds had not been met, no imports would occur. The legislation thus, gave an incentive to Indian car manufacturers to export (so that they could profit from cheap inputs). The Panel addressed this measure in the following manner:

> [As of the date of the establishment of the trade balancing condition,] there would necessarily have been a practical threshold to the amount of exports that each manufacturer could expect to make, which in turn would determine the amount of imports that could be made. This amounts to an import restriction. The degree of effective restriction which would result from this condition may vary from signatory [of a memorandum of understanding with the Indian government] to signatory depending on its own projections, its output, or specific market conditions, but a manufacturer is in no instance free to import, without commercial constraint, as many kits and components as it wishes without regard to its export opportunities and obligations.
>
> The Panel therefore finds that the trade balancing condition[,] . . . by limiting the amount of imports through linking them to an export commitment, acts as a restriction on importation, contrary to the terms of Article XI:1.[46]

After finding that the trade balancing requirements violated GATT Article XI:1, the *India—Autos* Panel invoked the principle of judicial economy and concluded that it was not necessary to analyse the measures under TRIMs.[47]

2.4 Procedural obligations

WTO members assumed the obligation to notify all trade-related investment measures that are not in conformity with TRIMs to the Council on Trade in Goods (TRIMs Article 5.1).[48] While no complaint has been lodged with regard to the implementation of that obligation, the notification record would seem to indicate that not all WTO members took this obligation seriously.

Going forward, WTO members assumed the obligation (TRIMs Article 6.2) to 'notify the Secretariat of the publications in which TRIMs can be found, including those applied by regional and local governments and authorities within their territories'. This transparency obligation covers both WTO-consistent and WTO-inconsistent measures.

2.5 Institutional provisions

A Committee on Trade-Related Investment Measures (TRIMs Committee) is established by virtue of TRIMs Article 7. The main task of the TRIMs Committee is to

[46] Ibid. paras. 7.277–7.278. [47] Ibid. paras. 7.323–7.324.

[48] TRIMs Art. 2.1 and the Illustrative List provided some guidance as to measures covered by the notification obligation. For further reading see, for example, WTO Doc. G/L/1091, Report (2014) of the Committee on Trade-Related Investment Measures (adopted 6 October 2014), 7 November 2014.

monitor the operation and implementation of TRIMs. The TRIMs Committee reports annually to the Council on Trade in Goods (TRIMs Article 7(3)). Pursuant to TRIMs Article 9, the Council on Trade in Goods was required by 1 January 2000 to 'consider whether the Agreement should be complemented with provisions on investment policy and competition policy'. No such review has taken place.

3. The General Agreement on Trade in Services (GATS)

3.1 Investment-relevant specific commitments

The GATS addresses foreign investment *explicitly* in Article XVI:2(f)[49], without, however, defining the term:

> [W]here market-access commitments are undertaken, the measures which a Member shall not maintain . . . unless otherwise specified in its Schedule, are defined as: . . .
>
> (f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign *investment* (emphasis added).

The purpose of the GATS is to lay down ground rules for trade in services, not for service-related investments. However, the GATS' wording reveals that the implications of trade rules for investments in service sectors were not absent from the negotiators' minds. As GATS law stands, it codifies multilateral rules for certain, albeit limited, aspects of FDI in services and, possibly even more importantly, constitutes a framework for multilateral liberalization of FDI, in particular with regard to financial services.[50] This legal regime is substantially less developed than the investment provisions in modern 'deep and comprehensive' free trade agreements (FTAs). However, the WTO Agreement's recognition of the members' rights 'to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives'[51] has become relevant again. Note, that NT and market access commitments do not apply to all WTO members, but rather only to those, which have entered into specific commitments with regard to very carefully circumscribed service sectors.

Many GATS provisions may have an effect on investment conditions. For instance, the MFN obligation in GATS Article II[52] requires that investment incentives or restrictions are applied equally to all foreign sources of inward service industry-related investments.

If a pertinent commitment has been entered into, investment-related measures, such as the screening of FDI proposals, economic benefit tests, or the condition for investors

[49] The term 'investment' is also used in the GATS Annex on Financial Services, to describe certain (investment-related) financial services.

[50] cf. GATS Annex and Second Annex on Financial Services; cf. also the Understanding on Commitments in Financial Services.

[51] Preamble, para. 4; see also Annex on Financial Services, para. 2(a).

[52] *EC—Bananas III* (Appellate Body), para. 233 *et seq*.

to acquire at least 25 per cent of equity, are subject to the NT obligation,[53] as the term 'affecting' is interpreted rather broadly.[54]

Note that the benefits are limited to 'service suppliers' of another member; in the case of a juridical person this requires ownership or control by nationals of another WTO member pursuant to GATS Article XXVIII. As a consequence, a foreign (portfolio) investor using an investment vehicle that is not fully controlled would not benefit from any of the GATS-based advantages.[55]

3.2 Investment-related GATS disciplines pursuant to mode 3 and mode 4

Modes 3 and 4, GATS describe forms of trade in services that entail the movement of persons and/or assets across borders: the former (mode 3, GATS Article I:2(c)) describes commercial presence as an integral part of the process of supplying a service. The latter (mode 4, GATS Article I:2(d)) requires the presence of natural persons (who supply services to the recipient(s) of a member) in the territory of any other member and has been, by far, the subject of the largest number of restrictions.[56]

GATS Article XXVIII(d) defines establishment, inter alia, as 'the constitution, acquisition or maintenance of a juridical person' or as 'the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service'. With this definition, the GATS establishes[57] a right of establishment for scheduled service sectors.[58] This entails a right to national treatment (pursuant to GATS Article XVII) in scheduled sectors with regard to both the establishment (of the commercial presence) and the post-establishment phase.[59] This is particularly significant, given the prevalence of post-establishment restrictions by host states.[60] However, while the inbound transfer of capital, and thus the effective use of the right to establishment, is ensured, the GATS remains silent on the outbound direction.[61] Disallowed measures affecting trade in services include 'measures in respect of the purchase, payment or use of a service'.[62]

[53] Panagiotis Delimatsis and Martin Molinuevo, 'Art. XVI GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *WTO—Trade in Services*, vol. 6 (Brill, 2008) 367, 388; Nellie Munin, *Legal Guide to GATS* (Kluwer, 2010) 152 *et seq*.

[54] See, for example, *China—Publications and Audiovisual Products*, paras. 7.970–7.971.

[55] Panagiotis Delimatsis and Martin Molinuevo, 'Art. XVI GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, Vol. 6 (Leiden: Martinus Nijhoff Publishers, 2008) 367, 389.

[56] Americo Zampetti and Pierre Sauvé, 'International Investment' in Andrew Guzman and Alan Sykes, eds., *Research Handbook in International Economic Law* (Edward Elgar, 2007) 211–71, 255.

[57] Clearly, subject to the 'terms, limitations and conditions agreed and specified in its Schedule', cf. GATS Art. XVI.

[58] See Ignacio Gómez-Palacio and Peter Muchlinski, 'Establishment' in Peter Muchlinski, Federico Ortino, and Christoph Schreuer, eds., *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008) 227–58, 245 *et seq*.

[59] Footnote 8 to the GATS clarifies a point of importance to investors: '[i]f a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(c) of Article I, it is thereby committed to allow related transfers of capital into its territory.'

[60] UNCTAD, *Preserving Flexibility in IIAs: The Use of Reservations* (United Nations, 2006), 44 *et seq*.

[61] This is in noteworthy contrast to the explicit coverage of payments for services supplied.

[62] GATS Art. XXVIII(c)(i).

GATS Article XI:1 establishes an additional, partially overlapping obligation by prohibiting to apply restrictions on international transfers and payments for current transactions relating to service sectors that are scheduled for market access or national treatment.[63]

Whereas the GATS does not provide an authoritative definition of 'market access', the list of prohibited (unless explicitly reserved) measures in GATS Article XVI:2 is an authoritative illustration of what market access is supposed to mean. According to Article XVI:2(e), 'measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service' are incompatible with the commitment to allow trade in a defined service sector, unless otherwise specified in the schedule. Thus, the provision prohibits two categories of state measures: first, it is incompatible with GATS to limit foreign service providers from benefiting fully from the range of legal franchises available. For example, many members allow the provision of legal services only if personal liability is ensured. In contrast, financial services may often only be offered by limited liability entities. States that wish to allow trade in banking and legal services and want to maintain the described liability rules have to inscribe this in the relevant modes 1 to 3. While this would include non-discriminatory measures,[64] the Scheduling Guidelines[65] give the following example for requirements that would require, in case of pertinent commitments, inclusion in the schedule: 'Commercial presence excludes representative offices', 'Foreign companies required to establish subsidiaries' and the information that in a given service sector 'commercial presence must take the form of a partnership'.

In addition to preventing the state from reducing the options as to the type of legal entities available for market access, GATS Article XVI:2 also aims at preventing a forced choice for service providers that seek commercial presence and thus intend to invest: GATS Article XVI:2(e) puts the *requirement* to proceed with 'local content' on the blacklist of those measures that will only pass scrutiny if specifically provided for in the schedules.

Limitations on the participation of foreign capital 'in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment' are only compatible with GATS, if the schedule contains a pertinent restriction of the scope of the commitment (GATS Article XVI:2(f)). The example given by the Scheduling Guidelines reads as follows: '(f) Limitations on the

[63] GATS Art. XI:2 specifies the relationship between scheduled capital transactions and the obligations of members pursuant to the Articles of Agreement of the International Monetary Fund (IMF); cf. Benedict Christ and Marion Panizzon, 'Art. XI GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, Vol. 6 (Leiden: Martinus Nijhoff Publishers, 2008) 245, 248.

[64] Panagiotis Delimatsis and Martin Molinuevo, 'Art. XVI GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll, and Clemens Feinäugle, eds., *Max Planck Commentaries on World Trade Law—Trade in Services*, Vol. 6 (Leiden: Martinus Nijhoff Publishers, 2008) 367, 386–7.

[65] WTO Doc. S/L/92, Trade in Services, Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS), Adopted by the Council for Trade in Serices on 23 March 2001, 28 March 2001, para. 12(e).

participation of foreign capital: Foreign equity ceiling of x percent for a particular form of commercial presence.'[66]

Minimum requirements are compatible with GATS law, unless they are discriminatory (which is frequently the case). Hence, it can be said that GATS Article XI:2 (f) establishes the right to invest for the purposes of obtaining commercial presence in a service sector, however, only on the conditions that (1) the pertinent sector has been included in its schedule, and (2) that there has been no reduction of the standard parameters in the schedule pursuant to GATS Article XVI:1. While it is thus not wrong to describe GATS Article XVI:2 as a prohibition of certain investment restricting practices, this prohibition is far from complete: if the schedules are drafted accordingly, it is possible to maintain those blacklisted measures.[67]

The GATS only covers the cross-border movement of the capital necessary to effectively supply a service to foreign customers. The amount needed for establishment can only be determined on a case-by-case basis: the right to establish commercial presence seems somewhat less comprehensive than the asset-based approach commonly found in international investment agreements (IIAs).[68]

Pursuant to GATS Article VI, members undertake to administer in a reasonable, objective, and impartial manner all measures of general application affecting trade in services; sudden hikes in visa fees in response to the rise of protectionist tendencies in the political process of a member may be in violation of that standard, for example. In addition, members undertake to provide judicial review and appropriate remedies. While this falls short of a protection against expropriation, it reduces the possibility of discriminatory measures that may come close to de facto expropriations. Also, GATS Article VIII, requests members to ensure that their monopoly suppliers of services will not discriminate between foreign partners and do not act in a manner inconsistent with their obligations under GATS Article II and their specific commitments.

Clearly, all investment-related provisions in the GATS are subject to the GATS' many exceptions, most notably the balance of payments exception (GATS Article XII) and the general exceptions (GATS Article XIV). They also extend only as far as the liberalization of trade in services is granted, which means that (due to the GATS' 'positive listing' approach) only scheduled sectors will benefit from the full scope of the GATS' protections for investors.

Note, that of the very limited number of GATS cases, only one dealt with certain aspects of mode 3 trade in services. In *Mexico—Telecoms*, the Panel examined whether Mexico had a commitment in effect to allow commercial agencies to supply the services at issue through commercial presence, and answered in the affirmative.[69]

[66] Ibid. para. 12(f); cf. *China—Publications and Audiovisual Products* (Panel), paras. 7.1361–7.1397.
[67] This option has been frequently used.
[68] Friedl Weiss, 'Trade and Investment' in Muchlinski, Ortino, and Schreuer, eds., *The Oxford Handbook of International Investment Law* (2008) 182–223, 194.
[69] *Mexico—Telecoms* (Panel), para. 7.353 *et seq.*

4. The Agreement on Subsidies and Countervailing Measures (SCM)

Investment incentives more often than not fit the definition of a subsidy, that is, 'there is a financial contribution by a government . . . and a benefit is thereby conferred' (SCM Article 1). It is this benefit that is supposed to attract FDI. This is certainly true for both direct financial incentives: fiscal incentives (tax breaks) and subsidized services. Tax breaks are caught by SCM Article 1.1(a)(1)(ii), as it defines a financial contribution as a 'government revenue that is otherwise due [which] is foregone or not collected (e.g. fiscal incentives such as tax credits)'. Subsidized services and goods fall under the SCM Article 1.1(a)(1)(iii), pursuant to which governments' provisions of 'goods or services other than general infrastructure' and governments' purchase of goods are subsidies provided they confer a benefit. However, incentive measures that may improve the status of an investment by granting it preferential regulatory treatment and insulation from further market entrants would escape the definition of a subsidy. However, such measures might very well collide with the standards developed with regard to the GATT's national treatment clause.[70] Clearly, any of these support measures are only outlawed or rendered countervailable, if they are specific pursuant to SCM Article 2. Hence, providing a first-class normative, administrative, and infrastructure *environment* is not a subsidy, despite the attraction a well-run state has for investors.

Investment incentives through subsidies contingent upon export performance of goods produced by the receiver of the subsidy are per se prohibited pursuant to SCM Article 3.[71] But regular subsidies are countervailable and WTO-incompatible, if and to the extent that they harm the interests of other members, for instance, by damaging industries that produce 'like products' (SCM Articles 6, 15).

5. The Agreement on Trade-Related Aspects of Intellectual Property (TRIPs)

The importance of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) for this overview stems from two interconnected aspects: first, in today's world, the assets of corporations consist increasingly of intangible assets; thus a member's intellectual property (IP) regime affects its attractiveness for inbound FDI. Secondly, and as a consequence of the first point, BITs regularly (and, in more recent years, always) contain provisions aimed at securing and enforcing the protection of intellectual property rights (IPRs). There is little doubt, thus, that a host country's system of IPR protection influences investment decisions both in general and with regard to the technology employed.

[70] *Indonesia—Autos* (Panel), para. 14.58 *et seq.*

[71] *EC and certain member States—Large Civil Aircraft* (Appellate Body), para. 1047: 'Where the evidence shows, all other things being equal, that the granting of the subsidy provides an incentive to skew anticipated sales towards exports, in comparison with the historical performance of the recipient or the hypothetical performance of a profit-maximizing firm in the absence of the subsidy, this would be an indication that the granting of the subsidy is in fact tied to anticipated exportation within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement'.

6. The Agreement on Government Procurement (GPA)

Due to pertinent carve-out clauses in the GATT and the GATS, government procurement is largely excluded from benefiting from the general national treatment obligations. The Agreement on Government Procurement (GPA) is an *à la carte* option open to those members who want to liberalize the field of government procurement. Remarkably, the GPA now goes beyond extending the national treatment obligation of GATT Article III to government procurements. GPA Article IV:2 explicitly states:

> With respect to any measure regarding covered procurement, a Party, including its procuring entities, shall not:
>
> (a) treat a locally established supplier less favourably than another locally established supplier *on the basis of the degree of foreign affiliation or ownership*; or
>
> (b) discriminate against a locally established supplier on the basis that the goods or services offered by that supplier for a particular procurement are goods or services of any other Party.[72]

Pursuant to GPA Article IV:6, parties, and in particular their procuring entities 'shall not seek, take account of, impose or enforce any offset . . . [w]ith regard to covered procurement'; according to GPA Article I(l), 'offset means any condition or undertaking that encourages local development or improves a Party's balance-of-payments accounts, such as the use of domestic content, the licensing of technology, investment, counter-trade and similar action or requirement'. However, GPA Article V exempts developing countries from most of these disciplines; note, that the group of WTO members are not obliged to sign on anyway, as the GPA is the only existing WTO agreement that is not part of the single undertaking approach according to which all WTO agreements annexed to the WTO Agreement are binding upon the members.

7. Outlook

Even after the public demise of the MAI project,[73] the trade and investment debate continued for some time. Following an initial discussion in the Singapore Ministerial Conference (1996), WTO members agreed at the Doha Ministerial Conference (November 2001) to undertake negotiations on trade and investment beginning in 2003.[74] The WTO, it was hoped, could do a better job than the Organisation for

[72] Emphasis added. The text of the modified GPA is reproduced in WTO Doc. GPA/113, Committee on Government Procurement, 'Adoption of the Results of the Negotiations Under Article XXIV:7 of the Agreement on Government Procurement, Following Their Verification and Review, as Required by the Ministerial Decision of 15 December 2011 (GPA/112), Paragraph 5 – Action Taken By the Parties to the WTO Agreement on Government Procurement at a Formal Meeting of the Committee, at the Level of Geneva Heads of Delegations, on 30 March 2012', 2 April 2012.

[73] cf. Peter Muchlinski, 'The Rise and Fall of the Multilateral Agreement on Investment: Lessons for the Regulation of International Business' in Ian Fletcher, Loukas Mistelis, and Marise Cremona, eds., *Foundations and Perspectives of International Trade Law* (Sweet and Maxwell, 2001) 114 *et seq*., 129–31.

[74] See WTO Doc. WT/MIN(01)/DEC/1, Ministerial Conference, Fourth Session, Doha, 9–14 November, 'Ministerial Declaration', adopted on 14 November 2001, 20 November 2001, para. 20.

Economic Co-operation and Development (OECD) in addressing the societal issues implicit in investment. Moving the discussion from Paris to Geneva certainly appeased, to some extent, the developing countries that had been instrumental in bringing down an OECD-based MAI. Unfortunately, the life of the WTO negotiating group on trade and investment was short: At the Cancún meeting of October 2004, which had been intended to become the Doha Mid-Term Review, members took the drastic decision to stop the negotiation on trade and investment.[75] The Doha work programme following a decision adopted by the WTO General Council on 1 August 2004, states:

> [T]he Council agrees that these issues [i.e. the relationship between trade and investment, interaction between trade and competition policy and transparency in government procurement], mentioned in the Doha Ministerial Declaration in paragraphs 20–22, 23–25 and 26 respectively, will not form part of the Work Programme set out in that Declaration and therefore no work towards negotiations on any of these issues will take place within the WTO during the Doha Round.[76]

This state of play, however, does not mean that developing countries (or, any other countries for that matter) are not interested in providing an environment attractive to foreign investors. Empirical research suggests a policy change on FDI which is being liberalized quite fast. According to the latest UNCTAD World Investment Report[77] developing countries and countries in transition attract more than half of global FDI flows. Cross-border FDI activity increased in 1990s by almost 60 per cent.[78] As per 2015, it has again reached pre-global financial crisis levels. While all this has happened despite the absence of a multilateral umbrella, the more than 3,000 BITs have created an environment that is complex and difficult to manage.[79]

A multilateral WTO agreement on investment measures would have to find an appropriate balance between the interests of capital exporters (among them the OECD countries, but also the BRICS and many Asian states) on one hand, and the interests of (both developed and developing) host countries, on the other hand, to allow forms of control and restriction, for instance for political, security, and, of course, developmental reasons.

[75] See Joel Trachtman, 'Trade and . . . Problems, Cost-Benefit Analysis and Subsidiarity' (1998) *European Journal of International Law* 9, 32–85; on the issue of linkage between trade and investment; Pierre Sauvé and Christopher Wilkie, 'Investment Liberalization in GATS' in Pierre Sauvé and Robert M. Stern, eds., *GATS 2000: New Directions in Services Trade Liberalization* (Brookings, 2000) 331–63 on the negotiation in the WTO.

[76] WTO Doc. WT/L/579, Doha Work Programme, Decision Adopted by the General Council on 1 August 2004, 2 August 2004, 3.

[77] UNCTAD, ed., *World Investment Report 2015* (United Nations, 2015).

[78] Pierre Sauvé and Arving Subramanian, 'Dark Clouds over Geneva? The Troubled Prospects of the Multilateral Trading System' in Robert Porter, Pierre Sauvé, Arvind Subramanian, and Americo Beviglia Zampetti, eds., *Efficiency, Equity, Legitimacy: The Multilateral Trading System at the Millennium* (Brookings, 2001) 16–33.

[79] Many voices were heard arguing for a trimmed down version of the ambitious MAI as a last hope for a multilateral agreement; cf. Bernard Hoekman and Michel Kostecki, *The Political Economy of the World Trading System* (Oxford University Press, 2001) 418 *et seq*.

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Competition Policy and Trade

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1. Introduction

Both competition policy and the WTO regime aim at establishing and maintaining a free market where the optimal allocation of economic resources is achieved through the price mechanism and competition among enterprises. Therefore, competition policy and the WTO share the same objective, namely, an economic system based on a market economy. Indeed, competition policy is an integral principle of the WTO regime, even though there is no WTO agreement on competition policy.

Competition policy is as much concerned with governmental barriers to competition as private anti-competitive conduct. Governmental barriers to competition and private restraints of competition are closely related. Governmental barriers to competition impose restrictions on the freedom of enterprises to compete. Private anti-competitive

conduct restricts competition through the abusive conduct of a monopolist or the collusive behaviour of enterprises. Even if governmental barriers to competition have been removed or reduced, private anti-competitive conduct may offset the benefit of the liberalization of economy afforded by the removal or reduction of such barriers. Therefore, with progressive liberalization of trade through negotiations sponsored by the GATT/WTO, it becomes increasingly important to take measures to control anti-competitive conduct of private enterprises that will counteract the results of liberalization. Thus, the introduction of competition policy into the WTO regime is a necessity if the effectiveness of the international trade regime is to be maintained. However, disparate views exist regarding whether, when, and how competition policy should be introduced into the WTO legal framework.

2. Anti-competitive Conduct that Adversely Affects International Trade

2.1 International, export, and import cartels

Enterprises of different nations may enter into an agreement to fix the prices of products, control the amount of production, or divide markets. Such an agreement is an international cartel. An international cartel affects international trade and offsets the benefit of trade liberalization achieved by the WTO. If the price of a product is fixed by an agreement entered into between enterprises of different nations and made uniform in the different national markets in which they operate, movement of that product across the boundaries of those nations is hindered. If national markets are divided among the enterprises of different nations, negative impacts on the flow of international commerce are obvious.

2.2 Boycotts, tie-in contracts, and vertical restraints

A boycott is a collective refusal to deal where a number of enterprises agree that they will not deal with a party or parties. Boycotts may adversely impact access to international markets. If, for example, a group of manufacturers with market power in a domestic market prevent their distributors and retailers from dealing imported goods that compete with the goods supplied by the manufacturers, the adverse trade effect is clear. In the 1980s and the early 1990s, a huge trade imbalance between the United States and Japan was a serious trade issue between the countries. Both governments engaged in a trade negotiation called the Structural Impediments Initiative (SII).[1] An important issue in this negotiation was anti-competitive conduct by Japanese companies that inhibited imports of US products into Japan. Because of this negotiation, the Japanese government (the Fair Trade Commission) published Distribution Guidelines,[2] in which it described conduct that would be regarded as constituting unfair

[1] On the SII, see Mitsuo Matsushita, 'The Structural Impediments Initiative: Example of Bilateral Trade Negotiations' (1991) *Michigan Journal of International Law* 12, 437–9.

[2] The Fair Trade Commission of Japan publishes a translation of the Guidelines in English. See The Executive Office, Fair Trade Commission, 'The Anti-Monopoly Act Guidelines Concerning Distribution

business practices and would, therefore, be prohibited. Among such conduct, boycotts were named as the most serious offence. This action shows that the Japanese government was keenly aware that boycotts of Japanese companies of foreign products had a great negative impact on access into the domestic market.

A tie-in contract is a contract whereby the supplier of one product (the tying product) conditions the sale of that product on the purchase by the purchaser of another product (the tied product). If, for example, the supplier of an operating system (the tying product) that is, the basic software for computers, imposes a condition on the purchaser or licensee that the latter must purchase or receive a licence for other software (for example, browser software and a tied product), this is a tie-in arrangement. A tie-in contract may exclude imports, because foreign suppliers are deprived of the opportunity to sell competing products. A tie-in contract is regarded as unlawful in many jurisdictions if the supplier has sufficient economic power with regard to the tying product.[3]

Vertical restraints restrict competition on different levels of trade. Examples include exclusive dealing arrangements, sole agency agreements, resale price maintenance, and vertical territorial allocation. Not all such restraints directly affect international trade, but some may adversely affect it. A typical exclusive dealing arrangement is a contract between a manufacturer of a product whereby the dealer or distributor is obligated to refrain from handling products of the manufacturer's competitors. If this contract is enforced by a powerful manufacturer or supplier in the domestic market, it will have a negative impact on the import of competing products.

Vertical restraints cannot automatically be presumed to have a negative impact on international trade. Some vertical restraints may have an anti-competitive effect and hinder foreign products from coming into the market. On the other hand, other vertical restraints may be neutral or even have a positive effect on trade, either in the short run or in the long run. Therefore, impacts of vertical restraints on international trade are more complex and need a case-by-case analysis.

2.3 Mergers and acquisitions

Mergers and acquisitions are primarily a domestic competition law issue. In some cases, however, mergers and acquisitions affect international trade. An enterprise may acquire a foreign competitor to block the importation of competing products. If this happens there is an impact on international trade. For example, Gillette (a US razor manufacturer) acquired stocks of Braun (a German razor manufacturer), a potential competitor of Gillette. The effect of this acquisition was to control exports of Braun to the US market. The US Justice Department proceeded against this acquisition and it was deemed to be a violation of Section 7 of the Clayton Act.[4]

System and Business Practices' (11 July 1991). For an analysis of the Guidelines, see Mitsuo Matsushita, 'Japanese Anti-trust Law in the Context of Trade Issues' in Hiroshi Oda, ed., *Japanese Commercial Law in an Era of Internationalization* (Graham Trotman/Martinus Nijhoff, 1994).

[3] For example, *Jefferson Parish Hospital District No. 2 v Hyde*, 466 US 2 (1984).

[4] *United States v Gillette Co.*, 406 F. Supp. (D. Mass. 1975).

Another case involved a merger between two Swiss pharmaceuticals manufacturers, Ciba and Geigy. These two companies had a large market share in the United States in pharmaceutical products such as valium. Both had subsidiaries in the United States, but due to the merger, those subsidiaries were to be controlled by one entity in Switzerland, Ciba/Geigy, and competition in the US market would cease to exist. The US Department of Justice proceeded against this merger and a consent decree was entered whereby Ciba/Geigy and its US subsidiaries agreed to establish another company, invest it with assets, technology, and other management resources, keep it for some time, and later sever the relationship with this company with the consent of the court. The idea was to create competition between the US subsidiary of Ciba/Geigy and a newly created entity in the United States.[5]

In the *Brunswick* case,[6] a US company, Brunswick, which manufactured and sold outboard engines for motorboats, entered into a joint venture with a Japanese company, Yamaha, that manufactured and sold the same product in order to prevent Yamaha from exporting outboard engines to the US market. The Federal Trade Commission issued a cease-and-desist order that required the cancellation of this agreement. The purpose of this joint venture was to stifle import competition.

Thus, mergers and acquisitions may have a significant impact on international trade. On the other hand, many mergers and acquisitions have no trade effect and belong to the realm of domestic regulation. In addition, mergers and acquisitions may be an important corporate strategy and governmental policy for industrial reorganization. Therefore, the regulation of mergers and acquisitions is primarily a matter of domestic policy of national governments and municipal laws. However, in situations in which the trade impact of mergers and acquisitions is clear, international review may be warranted.

3. Provisions on Competition Policy in the WTO Agreements

The framers of the ITO Charter took the decision to incorporate rules of competition law as part of the principles which would guide international trade. Thus, chapter 5 of the ITO Charter was devoted to competition policy. Although the ITO Charter was left in limbo when the GATT 1947 was signed (see Chapter 1) and no competition policy was adopted, it is important to remember that the genesis of competition policy in the WTO dates back to the 1940s, to the very beginning of the Breton Woods system.

Although a comprehensive agreement on competition policy is yet to take its place in the WTO regime, there are several provisions in the existing WTO agreements that deal with competition matters. In this respect, competition policy is already an integral part of the WTO.

3.1 The Agreement on Technical Barriers to Trade

The Agreement on Technical Barriers to Trade (TBT) provides that 'Members shall not take measures which have the effect of, directly or indirectly, requiring or encouraging

[5] *United States v CIBA Corp.*, 50 F.R.D. 507, 514, 1970 Trade Cas. (CCH) para. 73,319 (S. D.N.Y. 1970).

[6] *Brunswick Corp.*, 94 F.T.C. 1174 (1979), aff'd as modified sub.nom; *Yamaha Motor Co v FTC*, 657 F.2d 971 (8th Cir. 1981), cert. denied, 456 US 915 (1982).

such bodies [non-governmental bodies assessing conformity of products to technical regulations and standards] to act in a manner inconsistent with the provisions of Articles 5 and 6'.[7] TBT Articles 5 and 6 provide that, in the assessment of conformity by central government bodies, the principle of national treatment must be observed, technical regulations must not be more trade restrictive than necessary, and mutual recognition of technical regulations must be promoted. WTO members may not, therefore, require or encourage private bodies that perform product tests or issue certificates that products meet technical regulations and standards to discriminate against foreign products vis-à-vis domestic products or impose undue restrictions on imported products.

Standard setting has been recognized as a competition policy matter when it is performed by private enterprises. Often private enterprises form trade associations that perform product tests and issue certificates confirming that products meet technical regulations and standards. Such trade associations may discriminate against non-members' products and imported products. Such discrimination may violate competition laws. In the United States, there are a series of cases in which standard setting and testing practices of trade associations were held to be violations of the Sherman Act.[8]

This has been an important competition and trade issue in the US–Japan trade relationship. The United States argued that trade associations in Japan applied testing procedures in a manner that discriminated against foreign products and favoured domestic products. Because of the SII, a trade negotiation between the two governments, the Fair Trade Commission revised the Guidelines on the Activities of Trade Associations. The Guidelines state that, although standard setting by private associations may perform an important public function, restrictive activities of private associations setting product standards violate provisions of the Antimonopoly Law if they restrict access to conformity assessment procedures in a situation in which the utilization of such conformity assessment procedures is essential to carry on business.[9] The utilization of conformity assessment services should be open to any enterprise. In addition, the Guidelines state that, in situations in which private bodies are entrusted by the government to perform conformity assessment, their conduct will be subject to

[7] TBT Art. 8.1.

[8] See *National Macaroni Manufacturers Ass'n v FTC*, 345 F.2d 421 (7th Cir. 1965); *United States v Automobile Mfrs. Ass'n, Inc.*, 307 F.Supp 617, 1969 Trade Cas. (CCH) para. 721,907 (C. D. Cal 1969); *United States v Southern Pine Ass'n*, indictment returned 16 February 1940, Cr. 19, 903, E.D. La., civil complaint filed 21 February 1940, Civ. 275, E.D. La., consent decree entered 21 February 1940, 1940–43 Trade Cas. (CCH) para. 56,007; *United States v Western Pine Ass'n*, indictment returned 18 September 1940, Cr. 14, 522, S.D. Cal., civil complaint filed 6 February 1941, Civ. 1389–RJ, S.D/.Cal., consent decree entered 6 February 1941, 1940–43 Trade Cas. (CCH) para. 56,107; *United States v West Coast Lumbermen's Ass'n*, indictment returned 25 September 1940, Cr. 14,532, S.D. Cal., civil complaint filed 16 April 1941, 1940–43 Trade Cas. (CCH) para. 56,122; *United States v National Retail Lumber Dealers Ass'n*, indictment returned 14 April 1941, Cr. 9,337, D. Colo., civil complaint filed 3 January 1942, Civ. 406, D. Colo., consent decree entered 3 January 1942, 1940–43 Trade Cas. (CCH) para. 56,181; *United States v National Lumber Mfrs. Ass'n*, civil complaint filed 6 May 1941, Civ. 11, 262, D.D.C., consent decree entered May 6, 1941, 1940–43 Trade Cas. (CCH) para. 56,123; *United States v Retail Lumbermen's Ass'n*, civil complaint filed 24 October 1941, Civ. 378, D/Colo., consent decree entered 24 October 1941, 1940–43 Trade Cas. (CCH) para. 56,166.

[9] Guidelines on Activities of Trade Associations, Art 7.1 issued by the Fair Trade Commission of Japan (1995) (*Jigyoshadantai no katsudonikansuru dokusenkinshihojono shishin*).

scrutiny under the Antimonopoly Law and, if they discriminate against certain enterprises, they are in violation of the relevant provisions of the Antimonopoly Law.

Thus, if a WTO member encourages private conformity assessment bodies to discriminate against foreign enterprises, this constitutes a violation of the TBT Agreement (Article 8.1), and in many jurisdictions, a violation of their national competition laws.

3.2 Trade in services

Article VIII:1 of the General Agreement on Trade in Services (GATS) provides that each member shall ensure that any monopoly supplier of a service in its territory does not, in the supply of the monopoly service in the relevant market, act in a manner inconsistent with that member's obligations under Article II and specific commitments. GATS Article II provides for most favoured nation (MFN) treatment. Therefore, a member must ensure that a monopoly enterprise operating in its territory accords persons from any member treatment no less favourable than that which it accords to persons from any other member. If, for example, a member grants a monopoly to one enterprise in telecommunication in its territory, that member must ensure that the enterprise accords equal treatment to all persons who wish to utilize the service of that enterprise.

GATS Article VIII:2 provides that, where a member's monopoly supplier competes, either directly or through an affiliated company, in the supply of a service outside the scope of its monopoly rights and which is subject to that member's specific commitments, the member shall ensure that such a supplier does not abuse its monopoly position to act in its territory in a manner inconsistent with such commitments. If, for example, a member grants a monopoly to one enterprise in the area of railway transportation and has made a commitment in the area of trucking that it would accord the national treatment to enterprises of any other member, it must ensure that that monopoly enterprise does not abuse its monopoly power by engaging in predatory pricing in the area of trucking.

Article VIII:3 provides for the consultation procedure to be used by members when there is reason to believe that a monopoly supplier in a member engages in conduct which is inconsistent with the above two provisions. Article VIII:4 provides for a notification procedure by which a member must notify the Council of Trade in Services when it grants a monopoly to an enterprise in its territory which supplies services covered by its specific commitments.

GATS Article VIII:5 states that the provisions of this Article apply to cases of exclusive service suppliers, where a member, formally or in effect, (a) authorizes or establishes a small number of service suppliers; and (b) substantially prevents competition among those suppliers in its territory.

Furthermore, GATS Article IX:1, entitled 'Business Practices', states that members recognize that certain business practices other than those falling under Article VIII may restrain competition and thereby restrict trade in services. Article IX:2 provides for a consultation procedure whereby a member is obligated to enter into consultation with other members at the request of any other member with the view to eliminating such practices.

In the *Mexico—Telecoms* case,[10] the United States claimed that Mexico maintained measures requiring Mexican telecommunications operators to adhere to a horizontal price-fixing agreement led by Telemex, the leading telecom company in Mexico. A Mexican regulation obligated Telemex to negotiate with the suppliers of transmission of telecommunications to and from a foreign country a single settlement rate and then this rate applied to all other Mexican operators. Section 1.1 of Mexico's Reference Paper, entitled 'Prevention of anti-competitive practices in telecommunications', which forms part of the GATS states: 'Appropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anticompetitive practices.' The essence of the US claim was that the Mexican measures were contrary to this commitment.

The Mexican rule required Mexican operators to apply a uniform settlement rate and to ensure a proportionate return of incoming calls. Under this uniform settlement rate, Telemex must negotiate a settlement rate for incoming calls with suppliers in the other markets wishing to supply traffic to the Mexican market and apply, subject to approval by the Mexican authorities and in common with the other Mexican suppliers, that single rate to inter-connection for incoming traffic from abroad. The United States argued that the uniform settlement rate had the classic features of a cartel.

The Panel found the US argument convincing that the removal of price competition by the Mexican authorities, combined with the setting of the uniform price by the major supplier, had effects tantamount to those of a price-fixing cartel, and concluded that the uniform settlement rate under the Mexican rule required practices by a major supplier, Telemex, were anti-competitive within the meaning of Section 1 of Mexico's Reference Paper.[11]

Conduct that is specifically prohibited under the GATS is also subject to control under the competition laws of members. In the European Union (EU), for example, Article 82 of the European Communities Treaty (now Article 102 of the Treaty for Functioning of European Union (TFEU)) prohibits abuses of dominant positions by enterprises. An enterprise that enjoys a monopoly in a specific service area and engages in predatory pricing by using the monopoly profit earned in that monopolized area as a subsidy would infringe Article 82 (TFEU Article 102). In the United States, such conduct is prohibited under Section 2 of the Sherman Act as monopolization.[12]

3.3 National treatment

GATT Article III:4 prohibits members from discriminating against foreign products in favour of like domestic products in the application of 'all laws, regulations and

[10] Panel report, *Mexico—Telecoms*, WT/DS204/R, 1 June 2004.

[11] *Mexico—Telecoms*, paras. 7.260–7.261.

[12] For US cases, see *Inglis & Sons Baking, Inc. v ITT Continental Baking Co.*, 668 F.2d 1014 (9th Cir. 1981); *Liggett Group v Brown & Williamson Tobacco*, 744 F. Supp 344 (M.D.N.C. 1990); *Liggett Group v Brown & Williamson Tobacco*, 964 F.2d 335 (4th Cir. 1992); *Brooke Group, Ltd v Brown & Williamson Tobacco,* 509 US 209, 113 S. Ct. 2578, 1993–1 Trade Cas. (CCH) para. 70,277 (1993). For EU cases, see *Commission Decision of 14 December 1985 Relating to a Proceeding Under Art 86 of the EEC Treaty*, 1985 O.J. (L 374) 1 (hereinafter: *ECS/AKZO*) (1985); *Commission Decision of 24 July 1991 Relating to a Proceeding Under Art 86 of the EEC Treaty,* 1992 OJ (L 72) 1 (hereinafter: *Tetra Pak II*).

applications.' 'All laws' certainly includes competition law and, if a member applies its competition law favouring its domestic products and discriminating against like foreign products, this would constitute a violation of Article III:4.[13] If a member directs or allows by law or administrative measures including informal guidance, private enterprises in that country to discriminate against foreign products, such measures would constitute a violation of GATT Article III:4. Although cases where competition laws are applied in a discriminatory manner are rare, such application would raise competition law issues if they arise.[14]

3.4 TRIMs

Article 9 of the Agreement on Trade-Related Aspects of Investment Measures (TRIMs) provides that, within five years after entering into force, the Council for Trade in Goods shall conduct a review of the operation of this agreement and propose to the Ministerial Conference amendments to its text. It continues to provide that: 'In the course of this review, the Council for Trade in Goods shall consider whether the Agreement should be complemented with provisions on investment policy and competition policy'. Although nothing has happened in this regard since the inauguration of the WTO in 1995, the existence of this provision indicates that there was an awareness among the framers of the agreement that there is a close link between the subject matters covered by TRIMs and competition policy.

3.5 Antidumping

Article 3 of the Antidumping Agreement (AD) requires that, when determining injury to a domestic industry caused by dumping, the AD authority must take into account, inter alia, 'trade-restrictive practices of and competition between the foreign and domestic producers.' An interpretation of this provision is that an injury to a domestic industry may have been caused primarily by trade restrictive practices of foreign or domestic competitors rather than dumping and, if so, dumping should not be attributed as causing the injury suffered by the domestic industry.

3.6 Intellectual property and trade-related investment measures

Article 40 of the Agreement on Trade-Related Aspects of Intellectual Property (TRIPs) authorizes members to enact legislation prohibiting restrictive conditions attached to licensing agreements regarding intellectual properties. Article 40 provides, by way of example, exclusive grant-back conditions, non-contestability clauses, and coercive

[13] However, the essence of competition policy is non-discrimination and it is hard to imagine competition laws being applied in a discriminatory manner between domestic and foreign enterprises.

[14] Professors Ehlermann and Ehring maintain that the principle of national treatment enshrined in GATT 1994 Art. III:4 is necessarily extended to competition laws since competition laws are part of 'all laws' in that provision. See C. D. Ehlermann and Lothar Ehring, 'WTO Dispute Settlement and Competition Law—Views from the Perspective of the Appellate Body's Experience' (2003) *Fordham International Law Journal* 126, 1501–61.

package licensing. This list, of course, does not exhaust restrictive conditions that may be attached to licensing agreements and that may come under the prohibition of competition laws of members. Competition laws of members can cover other conditions such as excessive royalties, tie-in arrangements, and resale price maintenance. Although Article 40 is rather sketchy in specifying restrictive conditions that may be prohibited by the national legislation of members, this provision is a link between TRIPs, one of the WTO agreements, and competition policy and law.

3.7 Voluntary export restraints

The Agreement on Safeguards (SG), which supplements GATT 1994 Article XIX explicitly states in Article 11.1(a): 'Members shall not take or seek any emergency action on imports of particular products . . .', and, again in Article 11.3, 'Members shall not encourage or support the adoption or maintenance by public and private enterprises of non-governmental measures equivalent to those referred to in paragraph 1'. Under these provisions, voluntary export restraints (VERs), whether mandated by governmental measures or by private enterprises at a suggestion of a government, are prohibited. Thus, the WTO regime has successfully dealt with this issue.

4. Extraterritorial Application of Domestic Competition Law

4.1 What is extraterritorial application?

Although business activities are globalizing, competition laws are national laws rather than international law, except for the competition law of the EU. Although the reach of national competition laws are not necessarily limited to conduct that occurs within the territory of a state, the 'territorial principle' is still a basic rule of international law. However, given the situation where business activities cut across national boundaries, the reach of national competition laws has to be expanded to a certain extent to apply to conduct that takes place abroad. Here, issues of 'extraterritorial application' of national competition laws arise.

An extraterritorial application of competition law was first established in the United States in the *Alcoa* case.[15] In this case, the court declared that US antitrust laws could be applied to a conduct of a foreign national abroad if this conduct produced an 'effect' within the territory of the United States and that effect was intended. Since the *Alcoa* decision, there are many examples in which US national competition law was applied to conduct in a foreign country. Then US courts turned to the 'jurisdictional rule of reason' whereby US courts would refrain from imposing a stiff effect test and would decide on a case-by-case basis whether US laws would apply to conducts that occurred abroad, for example, US courts may refrain from exercising extraterritorial jurisdiction if such application is unreasonable when all the factors just discussed are taken into account.[16]

[15] *United States v Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

[16] *Timberlane Lumber Co. v Bank of America*, 549 F.2d 597 (9th Cir. 1976); *Mannington Mills, Inc. v Congoleum Corp.*, 595 F.2d 1287 (3d Cir. 1979).

In the *Hartford Insurance* Case,[17] the US Supreme Court endorsed the effect doctrine as enunciated in the *Alcoa* case[18] and also limited the scope of international comity so that conduct abroad which is subject to US antitrust laws can be excused from the application only when a foreign law requires the conduct and there is a direct conflict between the foreign law and US antitrust laws. It may be said, therefore, that the doctrine of international comity or the jurisdictional rule of reason is practically dead today. Foreign enterprises are subject to the application of US antitrust laws even though all of their conduct takes place abroad if their conduct produces harmful effects in the United States.[19]

In 1982, the US Congress enacted the Foreign Trade Antitrust Improvement Act (FTAIA)[20] which limits US antitrust laws to applying to conduct which takes place in a foreign country only if such a conduct has 'a direct, substantial and reasonably foreseeable effect in US commerce' and 'if such an effect gives rise to a claim' under such laws. This law somewhat limits the extraterritorial reach of US antitrust laws to conduct abroad.[21]

In the *Empagran* case,[22] the issue was the reach of the FTAIA in the area of private damage suits. The US Supreme Court emphasized the importance of comity in applying antitrust laws to international cases and held that the extraterritorial application of US antitrust laws to conduct abroad in private damage cases would be proper only when there is proximate cause between the conduct in question and the effect in the United States.[23]

After *Emagran*, there has been a substantial case law development in the United States. In 2014, the US Seventh Circuit Court handed down a decision which narrowly restricted the reach of US antitrust laws on conduct that takes place abroad. In *Motorola Mobility LLC v Au Optronics Corp., et al*,[24] foreign (Chinese) enterprises entered into a conspiracy abroad to raise prices of crystal panels (parts and components of cellphones) charged to subsidiaries of US enterprises abroad including the foreign

[17] *Hartford Fire Insurance Co. v California*, 509 US 764 (1993).

[18] See n. 15.

[19] See, for example, *United States v Nippon Paper Co.*, l, 109 F.3d 1 (1st Cir. 1999); *Dee K Indus. v Haveafil Sch. Bhd.*, 299 F.3d 281 (4th Cir. 2002).

[20] 69 Stat. 1233 (8 October 1922); 15 USC. 6 (a).

[21] See, for example, *Metro Industries, Inc. v Sammi Corp., et al*, 1996 Trade Cases, para. 76,913 (9th Cir. 1996); *United States v Nippon Paper Industries Co., Ltd, Jujo Paper Co., Inc., and Hironori Ichida*, 1996–2 Trade Cases, para. 71,575 (USD.C., D. Mass, 1996); *United States v Nippon Paper Industries, Co., Ltd*, 62 F. Supp. 2d 173 (D. Mass, 1999); *Dee-K Enterprises v Heveafil And. Rhd.*, 985 F. Supp. 640 (E.D. Va., 1997).

[22] *F. Hoffman-La Roche Ltd. v Empagran S.A.*, 542 US 155, 124 S. Ct. 2359 (2004). On this case, see Marissa Fitzpatrick, 'Hoffman-La Roche Ltd v Empagran S.A.: The Supreme Court Trusts that Foreign Nations Can Preserve Competition Without American Interference' (2005) *Tulane Journal of International and Comparative Law* 13, 357.

[23] The US Court of Appeals for the District of Columbia Circuit, to which the Supreme Court remanded the case, handed down a decision on 28 June 2005 in which the court held that a foreign plaintiff can recover the damage sustained abroad because of illegal effects of an international cartel under US antitrust laws only if the US effect is the proximate cause of the damage and denied a relief to the foreign plaintiffs. See *Empagran S.A v F. Hoffmann-Laroche, Ltd, et al*, 2005 WL 1512951 (D.C. Cir.). However, a US court subsequently granted relief to foreign plaintiffs in a case which involved similar factual situations. See *Monosodium Glutamate Antitrust Litigation*, 2 May 2005, WL 1080790 (D. Minn.), 2005–1 Trade Cases para. 74,781. Therefore, the precise scope of the Supreme Court's ruling seems not to be established.

[24] 746 F. 3d 842 C.A. 7 (Ill.), 27 March 2014.

subsidiary of Motorola, a US company, producing cellphones. The subsidiary purchased crystal panels abroad at inflated prices, produced cellphones with them there, and sold them to its parent, Motorola. Motorola brought a suit for the recovery of treble damages against the sellers of crystal panels for the reason that the cost of purchasing crystal panels was higher than it would have been if this cartel had not existed and cellphones incorporating such panels were brought into the United States and sold there at higher prices. It argued that this international cartel caused damages to Motorola and US consumers.

Judge Posner handed down a decision rejecting the claim of Motorola for the reason that this conspiracy did not come within the reach of US antitrust laws under the FTAIA because Motorola was not a direct purchaser of crystal panels and the effect of this international cartel on US foreign commerce was indirect. This narrow interpretation of the reach of US antitrust laws caused some alarm to the US enforcement agencies (US Justice Department and the Federal Trade Commission). The US Justice Department filed an *amicus curiae* brief to the court and vigorously argued that this narrow interpretation would jeopardize its enforcement activities against international cartels and requested an *en banc* proceeding. The Seventh Circuit vacated the opinion and granted a rehearing.[25] The Seventh Circuit handed down a decision in 2014 which is essentially the same as the previous decision except that it elaborated on the reason why the claim of Motorola could not be approved.[26] Again, in 2014, the Ninth Circuit handed down a decision in a case in which Korean and Taiwanese enterprises whose subsidiaries abroad produced crystal panels conspired abroad to fix prices of crystal panels to be used as components of cellphones. Crystal panels whose sales prices had been fixed by the Korean and Taiwanese companies were produced abroad by their subsidiaries and were purchased by foreign subsidiaries abroad of US companies who used them as components of cellphones that they produced. Cellphones were sold to US parent companies operating in the United States and were resold there to US users.

The Justice Department brought an indictment against those Korean and Taiwanese companies and the individuals CEOs of the companies for a violation of Section 1 of the Sherman Act. The Ninth Circuit affirmed the decision of lower court finding the defendants to be criminally liable and imposing fines and prison terms on them. The Court relied on the rationale that, in this case, import of products incorporating components which had been subjected to price-fixing was involved and, therefore, it constituted an exception to the FTAIA which excluded the application of US antitrust laws to conduct abroad except in stipulated exceptional circumstances.[27]

This second case faithfully follows the precedents established for the reach of US antitrust laws and there seems to be no fundamental change of case law jurisprudence in the United States on this issue as far as public enforcement of antitrust laws is concerned. Also this means that, in public enforcement of antitrust laws, a different jurisdictional rule applied compared with cases in which domestic private parties bring antitrust suits seeking treble damages.

[25] Rehearing granted, Opinion Vacated, 1 July 2014, WL 1878995.
[26] *Motorola Mobility LLC v Au Optronics Corp.*,_F. 3d_(2014), 2014 WL 667822 (A.C. 8 (Ill.))
[27] *United States v Hui Hsiung*, ___F. 3d___, 2014 WL3361084, C.A. 9 Cal.), 10 July 2014.

In 1995, the US Justice Department announced Antitrust Enforcement Guidelines for International Operations.[28] These guidelines set out Justice Department policy regarding conduct that occurs abroad but which harms the domestic economy. One feature of these guidelines is the emphasis on access to foreign markets. In a number of hypothetical examples used to explain the policy of the Justice Department, it is stated that the Justice Department may assert jurisdiction over conduct abroad that impedes market access of US enterprises. One such hypothetical example is a case in which enterprises in a foreign country engage in a boycott to block importation of US products. In this way, it seems that these guidelines take into account the 'export interests' of US enterprises.

In the EU, case law jurisprudence has been established that conduct which took place abroad would be subject to the disciplines of the EU competition laws as long as the conduct is implemented within the Union.[29] The best-known case is the *Wood Pulp* case,[30] in which the claim was that US enterprises exporting wood pulp to the European Community agreed to fix prices. The European Commission proceeded against this alleged cartel, and the case went to the European Court of Justice (ECJ). The ECJ ruled that, even if the conduct occurred abroad, EU competition law would be applicable if that conduct was 'implemented' within the Union.

In addition to the United States and the EU, extraterritorial application of competition law is spreading and becoming common practice among trading nations. Article 2 of the Chinese Antimonopoly Law states that provisions of the Law apply to monopolistic conduct in China or 'outside the territory of the People's Republic of China that has the effect of eliminating or restricting competition in the domestic market of the Peoples' Republic of China'.[31]

In the Japanese Antimonopoly Law, there is no provision specifically stating that its provisions apply to conduct abroad. However, in the *Samsung* case, the Japanese Fair Trade Commission took a bold step in applying the Japanese Antimonopoly Law.[32] This case involved a price-fixing international cartel in which Samsung, a Korean company, a Taiwanese company, and a Japanese company fixed prices. All of them owned subsidiaries in Malaysia and let them produce the tubes required for producing TV sets. The companies conspired abroad and decided to set the minimum price of tubes that the subsidiaries charged to customers there. Customers included the subsidiaries of Panasonic and other Japanese electronics companies producing TV sets incorporating tubes. The subsidiary of Panasonic (as well as

[28] US Department of Justice and Federal Trade Commission, 'Antitrust Enforcement Guidelines for International Operations' (1995) *Antitrust & Trade Reg. Rep. (BNA)* 68, 462, available at (1995) I.L.M. 34, 1080. For a detailed analysis of the guidelines, see Joseph P. Griffin, 'United States International Antitrust Enforcement: A Practical Guide to the Agencies' 1995 Guidelines, Number 53–2d' (1995) *The Bureau of National Affairs, Inc.*

[29] Art. 81 and Art. 82 of the Treaty of Amsterdam and the Merger Regulation.

[30] *Ahlstrom & Ors v EC Commission* [1988] E.C.R. 5193.

[31] For details of the Chinese Antimonopoly Law, see Stephen Harris, Jr, Peter Want, Yizhe Zhang, Mark A. Cohen, and Sebastien J. Evrard, *Anti-Monopoly Law and Practice in China* (Oxford University Press, 2011) 131 *et seq*.

[32] *Shinketsushu* (Fair Trade Commission Reporters) (2009) 56: 71.

subsidiaries of other Japanese electronics companies) produced TV sets using those tubes and sold TV sets to countries other than Japan.

The JFTC proceeded against Samsung and others on the ground that subsidiaries are nothing but the alter ego of the parents and sales to the subsidiaries are tantamount to sales to the parent. Thus, they were held liable to pay administrative fines for violating the Japanese Antimonopoly Law. Samsung objected and requested the JFTC to initiate an administrative hearing process. This proceeding is still pending at the time of writing.

4.2 Conflict of jurisdictions

Such extraterritorial application of national competition laws sometime causes a policy conflict among trading nations. Just to mention a case of such policy conflict, in the *GE/Honeywell* case,[33] the European Community prohibited a proposed merger between two American companies, GE (General Electric) and Honeywell, which was to take place in the United States. GE was a leading producer of jet engines for large commercial and regional aircraft. Honeywell was a leading supplier of non-avionics products as well as engines for corporate jets and engine starters, an important input in the manufacturing of engines. The US antitrust agencies, the Department of Justice, and the Federal Trade Commission, approved this merger. However, the European Community considered that this merger would create or strengthen the dominant position of GE and would severely reduce competition in the aerospace industry and result ultimately in higher prices for customers.

GE and Honeywell notified their merger agreement to the European Commission on 5 February 2001, and the Commission initiated an investigation to see if, after the merger, GE would have a dominant position in the markets for jet engines for large commercial and large regional aircraft. There was a proposal on the part of GE/Honeywell to restructure the merger plan, but the Commission rejected this proposal. The Commission concluded that the strong market position of GE, combined with its financial strength and vertical integration, assured the dominance of GE in the relevant markets. For this reason, the Commission refused to approve the merger. GE/Honeywell petitioned to the Court of First Instance in the European Communities and the decision of the Commission was upheld.

A high-ranking official of the US Justice Department stated that this merger would have been pro-competitive and beneficial to consumers. He is reported to have said that this difference in attitude between the European Commission and the authorities in the United States 'reflects a significant point of divergence'.[34]

[33] For the EC Commission Decision, see Commission Decision of 3 July 2001 declaring a concentration to be incompatible with the common market and the EEA Agreement Case COMP/M.2220-General Electric/Honeywell, O.J. L048, 18/02/2004, 0001–0085. For the view of the US Justice Department on this prohibition, see *Antitrust Division Chief Reacts to EU Decision to Prohibit GE/H Deal* (2015) *Antitrust & Trade Regulation Report*, Vol. 81 (BNA 6 July 2001) 15; *Daily Report for Executives*, No. 128 (BNA 5 July 2001).

[34] *Antitrust Division Chief Reacts to EU Decision to Prohibit GE/H Deal*, n. 33; *Daily Report for Executives*, n. 33.

This case is an important example of extraterritorial application of the competition law of the European Communities and of policy conflict between the United States and the European Communities with regard to merger control.

A brief survey of extraterritorial application of national competition laws shows that the national jurisdictions are becoming too narrow to deal with transnational business activities. To deal with this situation, it is necessary to establish a clearer jurisdictional rule of competition laws, establish convergence of competition laws of different nations, and create working mechanisms for international cooperation among enforcement agencies of competition policy and law. In this connection, there may be a role that the WTO can play in creating a forum for such cooperation and harmonization.

5. Trade Policy/Laws and Competition Policy

5.1 Trade policy and competition

Trade policies of nations are sometimes oriented to protecting their domestic industries from import competition. A trading nation may engage in restrictions of trade, such as the imposition of high tariffs and import quotas. In addition, as discussed in Chapter 11 on antidumping, trade remedy laws such as antidumping may be 'abused' so that the effect is to restrain competition in imported products. Such matters are of concern to competition policy because they may reduce market openness, which forms the basis upon which competition among enterprises occurs among the trading nations, and they are of immediate concern to the WTO, which deals with trade restrictions imposed by members. From a competition policy viewpoint, one may criticize the enforcement of such trade remedy laws. This issue, however, should be dealt with in a broader context of how to construct a proper balance between trade policy and competition policy.

5.2 The *Semiconductor* case

The semiconductor dispute between the United States and Japan was one of the biggest trade issues in international trade in 1980s.[35] The *Semiconductor* case arose from a series of trade measures applied by the US government to imports of Japanese semiconductor chips into the United States and the US demand for market access to the Japanese market of semiconductor chips. The US government initiated an antidumping investigation on imports of semiconductor chips from Japan. At the same time, the US government requested that the Japanese government take measures to increase the market access of foreign-made semiconductor chips in the Japanese market.

[35] See generally 'Symposium—Prevention and Settlement of Economic Disputes between Japan and the United States: Part II: Application of Framework to Specific Sectors and Issues: Lessons from the United States–Japan Semi-Conductor Dispute' (1999) *Ariz. J. Int'l & Comp. L.* 16, 91; Charles S. Kaufman, 'The US–Japan Semi-Conductor Agreement: Chipping Away at Free Trade' (1994) *U.C.L.A. Pac. Basin L. J.* 12, 329.

In 1986 the US–Japanese Semiconductor Agreement was agreed between the two governments to resolve these issues. Within the framework of this agreement, Japanese semiconductor manufacturers/exporters entered into suspension agreements whereby they promised the US antidumping authority that their export prices of semiconductor chips would not be lower than fair value (the domestic price). With respect to market access, both governments informally agreed that the Japanese government would ensure that the market share of foreign-made semiconductor chips would be 20 per cent or more. There was no official statement or any other evidence that such an agreement was entered into between the two governments. However, the US government believed that there was such a promise on the part of the Japanese government.

To ensure that the suspension agreements entered into between Japanese manufacturers/exporters and the US government regarding the export price of semiconductor chips would not be circumvented by Japanese exporters through exporting semiconductor chips to third countries at lower prices and then shipping them to the United States, the agreement contained a provision that the Japanese government monitor export prices of semiconductor chips shipped from Japan to third countries.

Subsequently the US government invoked Section 301 of the Trade Act of 1974 and decided that the Japanese government had violated the pact by allowing export of semiconductor chips to third-country markets at lower prices and by not securing the 20 per cent market share for foreign-made chips in the Japanese market.

Meanwhile, the European Community complained to the GATT that the requirement that the Japanese government monitor and control export prices to third-country markets, which included the EC, was a violation of GATT Article 11, prohibiting export/import restrictions. The GATT Panel decided the case in favour of the European Community.[36]

In 1991, the second US–Japanese Semiconductor Agreement was signed. With regard to dumping issues, the suspension agreements were maintained. In addition, a provision was incorporated into the agreement to the effect that foreign-made chips were expected to occupy a 20 per cent market share in the Japanese market. It also said, however, that this 20 per cent market share was not a promise or commitment on the part of the Japanese government, but was merely an 'expectation'.

Export control of chips to be exported from Japan to third countries was abolished and replaced by a provision which stated that, in case dumping of Japanese chips to a third country occurred, the United States would request that country to invoke its antidumping law and prevent dumped products from entering that country at dumped prices. This agreement was continued for five years and was replaced by a third Semiconductor Agreement in which the restrictive features were largely eliminated.

5.3 Competition policy implications of the Semiconductor Agreement

Although the Semiconductor Agreement did not present a case of direct conflict between competition laws and trade remedies, this also reflects tension between those two sets

[36] *Japan—Trade in Semi-Conductors*, 4 May 1988, GATT B.I.S.D. 35th Supp at 116 (1989).

of policy and law. The suspension agreement, which was part of the Semiconductor Agreement, required Japanese chip manufacturers not to lower the export price to the United States below the level of fair value (the domestic price in Japan). This necessitated Japanese chip manufacturers issuing instructions to their US subsidiaries to maintain the price of chips in the United States at a certain level, and there was a potential conflict between this pricing policy and US antitrust laws. Under US antitrust laws, resale price maintenance was regarded as a per se offence.[37] If Japanese manufacturers directed their US subsidiaries and affiliated companies to maintain a certain level of price when they sold chips, this could be regarded as resale price maintenance.

Under US antitrust laws, a transaction between a parent company and its subsidiary is regarded as an intra-corporate transaction and is given immunity if the latter is 100 per cent owned by the parent.[38] The case law is not clear, however, regarding a transaction between a company and its subsidiary or a related company if the former merely owns the majority of the stock of the latter.[39] Moreover, if a company owns a minority of the stock of another company, a transaction between them would probably not be deemed an intra-corporate transaction, and the prohibition on resale price maintenance would presumably apply.[40] Yet, under US antidumping law, if a foreign exporter owns even a minority of the stock of an importer in the United States, these two companies are regarded as related companies, and the resale price of the importer is regarded as the export price of the commodity involved. Therefore, in order to avoid a dumping charge the exporter has to direct the importer not to lower that price below the domestic price of the commodity in the domestic market in the home country.

The Japanese government asked the US Attorney General whether there was a possibility of an antitrust violation if Japanese exporters directed their US subsidiaries to maintain their sales prices in the United States as indicated by the directive of the exporters when they sold the imported products. The US Attorney General responded that he believed that any conduct which would be regarded as an implementation of antidumping legislation would be regarded as immune from antitrust liability.[41] However, there is no statutory authority or case law that endorses this position.

In addition, the Semiconductor Agreement had the same effect as an international cartel dividing international markets and fixing prices. Japanese exports of chips to the United States slowed. Competition thus decreased, and consumers paid high prices for

[37] *Dr Miles Medical Co. v John D. Park & Sons*, 220 US 373 (1911). Recently, the US Supreme Court reversed the ruling of *Dr Miles* and held that a resale price maintenance should be judged by the rule of reason. See *Leegin Creative Leather Products, Inc. v PSKS, Inc.*, 127 S. Ct. 2705 (2007).

[38] *Copperweld Corp. v Independence Tube Corp.*, 467 US 752 (1984).

[39] See Stephen F. Ross, *Principles of Antitrust Law* (Foundation Press, 1993) 179–82.

[40] In 2010, the US Supreme Court handed down a decision in *American Needle, Inc. v National Fooball League et al.* (<hppt://law.findlaw.com/us/000/08-661.html>) and generally followed *Copperweld.* However, the decision stated that the test of whether a parent company and its subsidiary are regarded as a single economic entity depends on the functions of the parent and the subsidiary rather than legal form and corporate structure. This probably added to the uncertainty.

[41] See Letter from Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, Department of Justice, to Makoto Kuroda, Vice-Minister for International Affairs, Japanese Ministry of International Trade and Industry, dated 30 July 1986, cited in US Department of Justice and Federal Trade Commission, Antitrust Enforcement Guidelines for International Operations, April 1995, 28, fn. 103.

chips. Meanwhile, outside parties to the agreement, such as Korean manufacturers, grew to be important players in this field.

5.4 The WTO dispute settlement system and competition policy

5.4.1 The Kodak/Fuji *case*

In the *Kodak/Fuji* case,[42] the United States brought a claim against Japan alleging that the Japanese government had directed Fuji, a Japanese photographic film manufacturer holding about 70 per cent of the market share in Japan, by way of administrative measures including informal guidance, to build an exclusive distribution network of films in Japan and thereby excluded the sale of films produced by Kodak, a US company, in the Japanese market. The United States brought a violation claim and a non-violation claim under the WTO agreements. In essence, the gist of the claims was that, when the film market in Japan was liberalized in the 1970s, the Japanese government imposed 'liberalization countermeasures' and the exclusivity of the Fuji distribution system was created by administrative directives of the Japanese government.

The WTO Panel, however, found that there was no ground for the United States to claim a violation and a non-violation of WTO agreements because the United States failed to prove a linkage between alleged administrative actions including informal guidance and the exclusive distribution network in Japan. In order to come under WTO agreements, there must be a 'governmental measure'. According to the Panel, however, there is no proof that there were Japanese governmental measures which restricted the entry of US-made films into the Japanese market.

The United States decided not to appeal the Panel ruling to the Appellate Body and, as far as this case is concerned, the Panel finding is final. Although the United States was the loser in this case, an important issue was raised. The issue was whether private restrictive activities exercised under governmental authorization and guidance would be covered by WTO agreements. The United States attempted to show that, although the exclusive distribution arrangement was created by Fuji, a private entity, the Japanese government played a decisive role in building this exclusive distribution network. The United States, however, could not adduce any direct evidence that proved it was the government which established this exclusive distribution network. All pieces of evidence produced by the United States were of indirect or circumstantial nature and the Panel held that this was not sufficient to prove that government measures had built this exclusive distribution network.

In this case, the United States may have aimed at the wrong target. The issues involved here were basically those of private restraints rather than governmental measures. Therefore, those issues should have been considered under competition law of either Japan or the United States. Vertical restraints are generally dealt with under the rule of reason in US and Japanese competition laws and so it is not certain

[42] Panel report, *Japan—Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R (22 April 1998).

whether such conduct constituted any violation of competition law.[43] On the other hand, issues of exclusive distribution and difficulty of entry into a domestic market due to such exclusivity have a close relationship with trade liberalization in the WTO regime. At the same time, this case shows that the current WTO dispute settlement procedure is ineffective at challenging private restraints of trade. Section 301 of the US Trade Act of 1974 states that a tolerance towards private restrictive conduct on the part of the government and the lack of the enforcement of competition law constitutes an unfair trade practice that could be subject to investigation under Section 301. However, in terms of the WTO jurisprudence, a mere toleration and non-application can hardly be said to constitute a 'measure' in the sense of WTO agreements.

This example shows that what is needed in the WTO regime is an agreement which would explicitly declare that members are obligated to ensure the openness of the market from private restraints.

5.4.2 The US 1916 Act *case*

The *US 1916 Act* case[44] dealt with issues of the Antidumping Act of 1916 in the United States. This law prohibited an import of a foreign product at the import price to the United States lower than the price of such product in the home market of the exporting country if such importation destroyed a US industry or caused monopolization or restraint of trade in the United States. This law provided for treble damages and a criminal penalty for a violation. The EC and Japan brought a claim against the United States on the ground that the Antidumping Act of 1916 dealt with dumping as defined in GATT Article VI and the Antidumping Agreement and, if so, remedies should be limited to those authorized by Article VI and the AD, for example, the imposition of antidumping duties. Since, however, the Act provided for treble damages and a criminal penalty, this was an excess and constituted a violation of GATT Article VI and the AD.

The United States, in response, argued that the Act was an antitrust statute rather than an antidumping statute and would not be ruled by GATT Article VI and the AD. However, the WTO Panel and the Appellate Body ruled that, since the Act applied to dumping, it should be classified as a dumping statute and must comply with Article VI and the AD. This was the basic reason why the Panel and the Appellate Body decided that the Act was inconsistent with GATT Article VI and the AD.

However, the fact that the 1916 Act was an antidumping statute does not necessarily exclude the possibility that it had some features of antitrust law as well. In 1995, the US Justice Department and the Federal Trade Commission jointly published Antitrust Enforcement Guidelines for International Operations, stating that, although the 1916 Act is not an antitrust statute, the subject matter dealt with by the law is closely related to predatory pricing, which is relevant subject matter for antitrust laws, suggesting that

[43] *Continental T.V., Inc. v G.T.E.Sylvania Inc.*, 433 US 36 (1977).

[44] Panel report, *United States—Anti-Dumping Act of 1916*, WT/DS136/R (31 March 2000) (the EC case); WT/DS162/R (29 May 2000) (the Japan case); (Appellate Body), WT/DS136/AB/R (28 August 2000) (the EC case); WT/DS/AB/R (28 August 2000) (the Japan case).

there is a close relationship between the two sets of laws.[45] In an appellate decision in a treble damages case brought by a US company against a Japanese company, the US Court of Appeals in the Eighth Circuit handed down a decision rejecting the claim of the Japanese defendant that an injury to a domestic industry should be regarded as an injury to the relevant domestic industry as a whole. However, one of the three judges in the Panel dissented and, in the dissenting opinion, he stated that an injury to a domestic industry in the sense of the 1916 Act should be an injury to a domestic industry as a whole since to interpret it narrowly and hold it as an injury to a particular company would stifle competition unduly and the freedom of competition is one of the fundamental values in the legal system in the United States.[46]

As stated in the Antitrust Enforcement Guidelines for International Operations, predatory pricing exercised internationally is relevant subject matter for antitrust laws (especially the Sherman Act), and situations envisaged by the 1916 Antidumping Act could come within the coverage of the Sherman Act.[47] Thus, the coverage of the antitrust laws and that of the Antidumping Act overlap at least in part. In this sense, the *US 1916 Act* case in fact straddles these areas of laws.

5.4.3 The Canada Dairy *case*

In the *Canada Dairy (II)* case,[48] the issue was predatory pricing. The Canadian government was accused of having provided a subsidy to exportation of fresh milk abroad. Originally the Canadian government controlled the price of fresh milk that was sold to processors of milk products to be exported. The United States challenged this price control as being a direct export subsidy given to the exportation of milk products. The WTO Panel and the Appellate Body held that this was an export subsidy that was inconsistent with the SCM Agreement. The Canadian Government in response modified the regime by terminating price controls on milk sold for export.

The United States challenged the reformed system, arguing that the reform was still a contravention of the Agreement on Subsidies and Countervailing Measures (SCM) and the Agreement on Agriculture (AoA). The Appellate Body agreed, ruling that this regime could be an illegal subsidy if producers of fresh milk sold it at a price below cost of production to producers of milk products to be exported. However, the Appellate Body held that it could not determine whether the sale was below cost or not due to the lack of fact finding on the part of the Panel.

The *Canada Dairy* case primarily concerns the SCM. However, below cost selling of milk by producers of fresh milk to producers of milk products gives the producers of milk products undue advantages. In terms of competition law, this practice could be regarded as predatory pricing and, given the extraterritorial effect of competition laws

[45] Antitrust Enforcement Guidelines for International Operations, Issued by the US Department of Justice and the Federal Trade Commission (April 1995), para. 2.82.

[46] *Tokyo Kikai Seisekusho, Ltd v Goss International Corp.*, 2006 WL 155253 (8th Cir., Iowa, 23 January 2006).

[47] *Matsushita Elec. Inds. Co. v Zenith Rjadio Corp.*, 475 US 574 (1986).

[48] *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/JRW (3 December 2001).

in major jurisdictions, this kind of practice is subject to challenge under competition laws as well as under the SCM. This is another example of overlap between competition laws and the WTO agreements.

5.4.4 *The* Mexico—Telecoms *case*

In the *Mexico—Telecoms* case,[49] a WTO Panel dealt with competition policy issues related to the GATS. Please see section 3.2 of this chapter.

5.4.5 *Voluntary export restraint and competition policy*

Until the coming into being of the WTO, one of the serious trade issues in world trade was the relationship between voluntary export restraints (VERs) and competition laws.[50] VER was a device often used to resolve trade conflicts between exporting countries and importing countries. When an export of a product threatened a domestic industry of the importing country, the latter requested the exporting country to restrain export to the importing country. The government of the exporting country invoked its export licensing powers and prohibited or restricted export of the product in question to the importing country. Sometimes the government of the exporting country directed or advised its exporters to enter into export cartels whereby exporters jointly restrained the amount of export or fixed export prices.

VER was often used in US/Japanese trade and EC/Japanese trade in important areas such as steel, textiles, automobiles, machine tools, semiconductors, and some others. There are many instances in which export restraint measures exercised by the Japanese government was subjected to US antitrust scrutiny. One such case is the *US Consumers' Union* case.[51] In this case, decisions of the US District Court for the District of Columbia and a decision of the Court of Appeals in the United States were handed down. The facts were that a US consumers group challenged a VER between the United States and Japan. In the face of increasing imports of steel from Japan, the US government approached the Japan Steel Export Association, a trade association composed of steel makers in Japan, and requested that the Japanese exporters restrain export of steel to the United States. Thereupon the Japanese exporters organized an export cartel limiting the quantity of steel to be exported to the United States.

The US Consumers Union challenged the US government and the Japanese exporters on the ground that the US Executive Department exceeded its authority by entering into a trade agreement with Japanese exporters without any statutory authority and sponsoring a cartel between Japanese and US industries. The District Court in the United States held that the President of the United States had a wide discretion regarding diplomacy and the power to enter into a trade agreement with foreigners

[49] Panel report, *Mexico—Telecoms*, WT/DS204/R (2 April 2004).

[50] See, for details, Mitsuo Matsushita, 'Coordinating International Trade with Competition Policies' in E-U Petersmann and M. Hilf, eds., *The New GATT Round of Multilateral Trade Negotiations—Legal and Economic Problems* (Kluwer, 1987) 396–435.

[51] *Consumers Union of the United States, Inc. v Kissinger*, 506 F. 2d 136 (D.C. Cir. 1974); *Consumers Union of the United States, Inc.. v Rogers*, 352 F. Supp. 1319 (USDC, D.C., 1973).

was included in this discretion. With regard to the cartel issue, the US plaintiff withdrew its claim on antitrust laws. The District Court held that, since the plaintiff withdrew its antitrust claim, it would not make a ruling on this issue but, at the same time, mentioned that, had the plaintiff not withdrawn the antitrust claim, there would have been a serious issue of a potential antitrust offence. Both the plaintiff and the defendants appealed. The Court of Appeals affirmed the decision of the District Court with regard to the power of the President to enter into a trade agreement with foreigners. Also the Court of Appeals held that, when the plaintiff withdrew the antitrust claim, it ceased to be an issue of litigation and the Court would refrain from making a judgment on this issue. Therefore, the relationship between VERs and the US antitrust laws was left unresolved and remains so today.

An antitrust issue was raised in other VER cases such as the Japanese VER in automobiles.[52] In this case, the Japanese government constructed an elaborate export scheme to restrain export of automobiles to the United States. The Japanese government issued a directive allocating the number of automobiles which each exporter could export and stated that, should this directive be not complied with, the government would invoke a compulsory export licensing power and thereby force the exporters to comply. The Japanese government requested the view of the US Attorney General as to whether this arrangement was immune from antitrust challenges. The Attorney General replied that 'he believes' that there would be no problem.

5.5 The relationship between antidumping and antitrust

Another important aspect of the relationship between trade remedies and competition policy is that between antidumping measures and competition policy.[53] Indeed this is one of the issues discussed in the Working Group on Trade and Competition established by the WTO in 1997. There were some delegates who argued that antidumping should be modified by the principles incorporated in competition laws. Others claimed that the constituency of antidumping is different from that of competition laws and there would be no common ground for the two. The Working Group could not reach any consensus regarding this issue.

In practice, there are some cases in which tension between antidumping and competition laws are witnessed as discussed below.

5.5.1 The Fax Paper *case*

In the *Fax Paper* case,[54] Japanese companies operating in the American market were suffering competitive pressure from their US competitors and losing market share.

[52] See, for details, Mitsuo Matsushita and Lawrence Repeta, 'Restricting the Supply of Japanese Automobiles: Sovereign Compulsion or Sovereign Collusion?' (1982) *Case Western Journal of International Law* 14, 47–77.

[53] On this issue, see Mitsuo Matsushita, 'Interplay of Anti-dumping Remedies and Competition Laws—Tensions and Compromise between Anti-dumping and Antitrust' in M. Matsushita, D. Ahn, and T-L Chen, eds., *The WTO Trade Remedy System—East Asian Perspectives* (Cameron May, 2006) 123–44.

[54] *United States v Nippon Paper Industries Co., Inc., and Hironori Ichida*, 1996–2 Trade Cases, para 71,575 (U.S.D.C., D. Mass, 1996) (District Court decision); *United States v Nippon Paper Industries Co.,*

US competitors threatened an antidumping action against the Japanese companies and indeed antidumping claims were filed with the US Commerce Department. Considering that antidumping investigation were costly and antidumping duties would make it impossible for them to export to the United States, the Japanese companies entered into an agreement in Japan fixing the price at which fax paper that they exported would be sold in the US market.

The US Justice Department initiated a criminal investigation and brought an indictment against those companies and their executive officers. The US District Court held that US antitrust laws did not apply to the conduct of the defendants for the reason that precedents in US antitrust jurisprudence which allowed an extraterritorial application of antitrust laws were all civil cases and, since the application of criminal law needs to be more restrained, these precedents would not be used in the present case. The US Justice Department appealed and the Court of Appeals reversed the decision of the District Court. The Court of Appeals held that, regardless of whether it was a civil or a criminal case, it was still a matter of interpreting the same provision (Section 1 of the Sherman Act) and the same principle of extraterritorial jurisdiction should apply. The case was remanded to the District Court. During the course of proceedings, some of the defendants pleaded guilty and settled the case, but one of the defendants, the Nippon Paper Company, fought it to the end. The District Court handed down its judgment that the defendants were not guilty.

There were two reasons for this not guilty verdict. One was that the plaintiff, the US Justice Department, did not adduce sufficient evidence to show that the alleged foreign cartel produced a direct, substantial, and reasonably foreseeable effect in the foreign commerce of the United States. In fact, while these Japanese companies were engaged in the price-fixing arrangement, they continued to lose market share in the United States. When they raised prices in the US market, they lost the market completely. The Court stated that this set of facts indicated that the alleged conspiracy did not produce a sufficient effect in the United States to establish extraterritorial jurisdiction of US courts under the FTAIA. Another reason was that the case had become time-barred before the US Justice Department brought an indictment.

5.5.2 The Malaysian ETR *case*

The *Malaysian ETR* case[55] is quite similar to the *Fax Paper* case except that the former case arose from a private action filed by purchasers of the products in question. The defendants in this case were Malaysian and other Southeast Asian companies producing and selling ETR (rubber products) to the US market as well as other international

Inc., and Hironori Ichida, 109 F. 3d 1 (1st Cir. 1999) (Appellate decision) and *United States v Nippon Paper Industries Co., Ltd, formerly Jujo Paper Co., Ltd,* 62 F. Supp. 2d 173 (D. Mass, 1999) (District Court decision on remand).

[55] *Dee-K Enterprises, Inc. et al. v Haveafil Sdb Bhd et al.*, 982 F. Supp. 1138 (U.S.D.D., E.D.Va., 1997), *aff'd* 99 F. 3d 181 (4th Cir. 2002).

markets. The US Commerce Department initiated an antidumping investigation against the Malaysian companies and determined that the highest dumping margin was 50 per cent. During and after the antidumping investigation, the defendants discussed among themselves and with the Malaysian government ways to deal with this trade issue and, at the suggestion of the Malaysian government, decided jointly to fix the export price of ETR destined for the United States.

The purchasers of ETR in the United States brought an antitrust claim against the Malaysian companies and sought treble damages. At US District Court level, the jury found that there was a conspiracy among the defendants. However, there was no direct, substantial, and reasonably foreseeable effect on US foreign commerce as required by the FTAIA since it was not clear whether the price of ETR went up because of the price-fixing agreement abroad or the imposition of antidumping duties. The plaintiffs bore the burden of proving such effect, and they had not met this requirement. The plaintiffs appealed this decision to the US Court of Appeals, and the Court, following the *Hartford Fire Insurance* case, ruled that an antidumping threat cannot be used as an excuse for a price-fixing cartel because antidumping laws do not require cartels and uniform prices.[56] However, the Court of Appeals found further that a direct, substantial, and foreseeable effect of this foreign cartel was not proven and that, therefore, there was no ground for applying the Sherman Act to the case.

5.5.3 The Saskatchewan Potash *case*

The *Saskatchewan Potash* case[57] is another interesting case dealing with the relationship between antidumping and antitrust. The facts in this case were quite complicated but a brief overview of the essential elements will be given. In this case, an antidumping investigation was initiated against Canadian potash producers. After the preliminary determination of dumping, the US Commerce Department required that the respondents post bonds to meet the respective dumping margins. Later the respondents entered into suspension agreements with the US Commerce Department whereby they would raise their export prices to the United States. The major producer and exporter of potash, PCS, took the lead and decided to raise its export price by $18 per ton. All other Canadian producers quickly followed suit and raised their prices by that amount.

Consumers of potash in the United States brought an antitrust claim and argued that this was a price-fixing cartel. The US District Court which handled the case decided that although PCS, the leading Canadian company, raised its price and all other Canadian producers followed suit and raised the prices by the same amount, there was no clear evidence of conspiracy among the Canadian producers. The court reasoned that they engaged merely in 'consciously parallel but independent conduct' and this did not constitute a price-fixing cartel.

[56] See section 4.1 of this chapter.

[57] *Blomkest Fertilizer, Inc. v Potash Corp. of Saskatchewan, Inc*, 2000 Trade Cases, para. 72,812 (8th Cir. 2000).

5.5.4 The US–Japan Semiconductor Agreement

One aspect of the US–Japan Semiconductor Agreement was related to competition policy.[58] For more details, please see section 5.3.3 of this chapter.

5.5.5 Confrontation and compromise between antidumping and competition policy

The above review of major cases in antidumping and competition laws reveals a delicate and uneasy relationship between those two sets of laws. In theory, both antidumping and competition laws aim at the maintenance of 'fair competition'. In reality, however, there is a wide gap between antidumping and competition law. In fact, there are often outright collisions between those two sets of law. The above review of the situation seems to suggest that an introduction of agreement on competition policy and the promotion of coordination between antidumping and competition principle within the framework of the WTO would ease tension between the two and contribute greatly towards legal stability with regard to trade remedies in relation to competition policy.

5.6 Export cartels and import cartels

Export cartels and import cartels directly affect international trade and, therefore, they are of great concern for international trade system as well as competition policy. Export cartels and import cartels have different features so we will deal with each separately.

5.6.1 Export cartels

Export cartels whereby exporters of a country agree on export prices, quantities, kinds of commodities to be exported, or on allocation of customers restrict export trade in one way or another. Views have been expressed by commentators that trading nations should agree to impose a prohibition or some kinds of disciplines on export cartels. In 2012, OECD's Committee on Competition Policy held a conference on export cartels and the chairperson (Frederick Jenny) stated that export cartels are harmful to international trade and some disciplinary action should be taken to control them.[59] A special committee on international antitrust of the American Bar Association had earlier published a report (1991) in which it recommended that export cartels should be prohibited.[60]

However, at present, export cartels are generally allowed by the competition laws of major trading nations. Export cartels adversely affect the interest of the importing

[58] For details, see Dorinda Dallmeyer, 'The United States–Japan Semiconductor Accord of 1996: The Shortcomings of High Tech Protectionism' (1989) *Maryland Journal of International Law and Trade* 13, 179; 'Symposium', n. 35 at 91; Kaufman, 'The US–Japan Semi-Conductor Agreement', n. 35 at 329.

[59] BNA, Antitrust & Trade Regulation Report, Vol. 102, No. 2537 (24 February 2012) 248.

[60] Special Committee on International Antitrust Report, 1 September 1991, ABA Section of Antitrust Law.

country but they do not bring about immediate adverse effects on the exporting country. This may be a reason why trading nations are not enthusiastic about creating international rules to prohibit or control export cartels. On the other hand, importing countries have applied their competition laws to prohibit export cartels of exporting countries though extraterritorial application of their competition laws.[61]

There have been several recent antitrust cases in the United States where foreign export cartels were the targets. In the *Spectrum* case, US companies brought an antitrust suit against OPEC for the reason that, due to restriction of international trade by OPEC, their interests were adversely affected. However, the Fifth Circuit Court of Appeals dismissed the claim on the ground that activities of OPEC would come under the act of state doctrine.[62] In the *Pesco Products* case,[63] a claim was brought by US importers that Chinese exporters were engaged in export cartels of minerals and that this amounted to a violation of the Sherman Antitrust Act. The court noted that, at the time when this suit was brought, proceedings were underway at the WTO dispute settlement procedure on the same subject matter, that is, export restrictions of minerals by the Chinese government, thus the litigation in the United States should be stayed until a conclusion was reached at the WTO dispute settlement procedure. This suggests that the Chinese government utilized export cartels as a means to carry on the export quota system imposed by the government.

In re Vitamin C. Antitrust Litigation,[64] a similar issue was raised. Chinese exporters of vitamin C entered into an export cartel agreement, fixing prices and quantities of vitamin C to the United States. US purchasers brought an antitrust suit against the Chinese exporters for a violation of US antitrust laws. The Chinese government (MOFCOM) issued a statement that this export cartel was compelled by government and therefore should be excused by the act of state doctrine or the foreign government compulsion doctrine. The US District Court stated that a statement by a foreign government to the effect that it compelled conduct of private persons deserves respect but, under the circumstances of this case, the statement of the Chinese government could not be accepted. Therefore, the defence by the Chinese exporters on this ground was denied and the case was ordered to be put to further proceedings.

Another important case on foreign export cartels and US antitrust laws is *Minn-Chn.Inc. v Agrium Inc*,[65] in which US potash purchasers brought an antitrust suit against a foreign export cartel agreed upon by Russian, Belarusian, and Canadian producers/exporters on price and quantity of potash. Together they controlled 65 per cent of the total production of this product and, during the period 2008–09, raised export prices by 450 per cent. The Seventh Circuit Court held that this subject matter was within the scope of the FTATA. The main subject matter in this case was

[61] *Daishowa International v North Coast Export*, 1982–2 Trade Cases, para. 64,774 (N.D. Cal. 1982).

[62] *Spectrum Stores, Inc., et al. v Citgo Petroleum Corporation et al.*, 635 F. 3d 938 (5th Cir., 2011) A similar judgment had been given earlier in *IAM v OPEC*, 469 F. 2d 1354 (9th Cir., 1981).

[63] *Pesco Products, Inc. v Bosai Minerals Group Co. and CMP Tianjin Co., Ltd.*, 2010 Trade Cases, para. 7,061 (U.S.D.C., W.D. Pa. 2010).

[64] *In re Vitamin C. Antitrust Litigation*, Case 1: 60-md01738-BMC-JO Document 440, Filed 09/06/11 (U.S.D.C., E.D. NY).

[65] *Minn-Chen, Inc. v Agrium Inc.*, 7th Cir. (No. 10-1712, 6/27/12).

whether the requirement of the FTAIA (that there be a direct, substantial, and reasonably foreseeable effect within the United States) is that of jurisdiction or of subject matter. However, this is a US law question and, in one way or other, this subject matter, foreign export cartels, is covered by US antitrust laws.

In the EU, it was established early in the famous *Wood Pulp* case (see section 4.1) that the EU competition law would apply to conduct abroad that is implemented within the EU. The *Wood Pulp* case in fact dealt with whether the EU competition law would apply to export cartels of wood pulp in the United States and Canada. The European Court of Justice decided that there was insufficient evidence to prove that an agreement to fix the terms of export existed between those foreign exporters, and, for this reason, the case was dismissed. However, this decision serves as a precedent that EU competition law would apply to export cartels abroad.

As touched upon earlier, it is established in the US and EU case law that foreign export cartels are subject to rules of competition law in those countries or entity. However, there is not yet an internationally agreed norm as to whether and to what extent competition laws of trading nations can apply to foreign export cartels and this is left to future enforcers of competition laws and their critics to decide.

In major jurisdictions, export cartels are subject to filing with the government or an approval by the government. For example, the Japanese Export and Import Transactions Law (Article 5:1) authorizes Japanese exporters to enter into agreements on the terms of export (export prices, quantity, channels for distribution, etc.) on the condition that such agreements are filed with the Ministry of Economy, Trade and Industry (the METI). This body can intervene and order the exporters to change the terms of export if it judges that the export agreement in question does not satisfy the requirement of export agreement in the Law. Also if an export agreement is not effectively implemented due to the activities of outsiders, the METI can step in and issue an order which requires all exporters of the product in question to abide by the terms of export agreement (the outsider regulation).

If there is sufficient government hand in the enforcement of export cartels, this may raise the question of whether they run counter to GATT Article XI:1 because export cartels may restrict export quantity as in the case of the *Chinese Vitamin C* case. This is as yet unexplored territory. However, in the future, export cartel matters may come to the WTO dispute settlement procedure for an infringement of GATT Article XI:1.

5.6.2 Import cartels

Import cartels are agreements among importers to fix terms of import such as import prices, quantity, and so on. For example, importers enter into an agreement whereby they agree not to deal with exporters which set export prices above a certain level. Import cartels generally adversely affect the interests of foreign exporters and often the domestic purchasers or consumers of the importing country too because import prices of the product subject to import cartels tend to be higher than they would be if there were no such import cartels. For this reason, import cartels are generally regarded as being contrary to competition laws of the exporting countries as well as importing countries.

However, there are situations where import cartels are necessary or reasonable as exemplified in the following hypothetical situation. Suppose Company A in Country X has a monopoly in Mineral Z. Mineral Z is an essential material for the production of electronic devices and very rare on earth. In Country X, the government has a policy of controlling and preserving Mineral Z and, for this purpose, grants Company A the exclusive right to produce and distribute it. Export of Mineral Z is monopolized by Company A and also the government of Country X imposes restrictions on export of Mineral Z including export price. In this situation, importers of Mineral X in Country Y agree to form a purchasing consortium and the consortium is given the exclusive power to negotiate with Company A in respect of export and import prices of Mineral X. It is crucial for industries and the economy as a whole of Country Y to acquire Mineral X at a reasonable price. In this situation, the question is whether free and fair competition in regard to export and import of Mineral X can be expected due to a monopoly of Mineral X in Country A.

There is no clear-cut rule in the competition laws of major trading nations as to whether a purchasing consortium is justified when dealing with a foreign monopoly in exportation. However, some examples are given from meagre sources.

In *Hunt v Mobile Oil Corp.*,[66] petroleum companies in the United States and Europe formed a consortium to deal with the oppressive policies of the Libyan government towards oil companies operating in Libya. The Libyan government imposed harsh conditions on the terms of operating oil wells and often confiscated production facilities. The companies joined together and agreed that they would always deal with the Libyan government together and, when the terms of transactions imposed by the Libyan government were unreasonable, jointly refuse to deal with it. They submitted this plan to the US Justice Department and sought a business review letter. The Justice Department responded by stating that it had no intention of bringing an antitrust action against this consortium.

The US Justice Department did not explain why it would not take action against this plan and this is an old case. The decision of the US Justice Department may have been based on the understanding that the activities of this consortium only took place in a foreign country and no appreciable effect would be felt in the United States. However, this precedent could be cited as an example for no action being taken by competition authorities when dealing with extreme situations such as that occurring in this case. To draw an analogy, one might speculate that, when importers take a joint action to deal with a foreign monopoly supplier, such a joint action would be excused or at least be treated by the rule of reason test.

In the EU, the guidelines on horizontal agreements[67] discuss the conditions under which a purchasing agreement is allowed. According to these guidelines, two markets should be considered when examining whether a purchasing agreement is allowed, namely (a) the market in which purchasers/importers import products (upstream market) and (b) the market in which purchasers/importers sell products made from

[66] *Hunt v Mobile Oil Corp.*, 550 F. 2d 69 (2d Cir., 1977).

[67] Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operating agreements, Official Journal of the European Union, C11, 1.4.1.2011.

the imported products (downstream market). The guidelines state that if the purchasers have a market share (presumably in both markets) of 15 per cent or less, they are presumed to have no market power and a joint purchasing agreement between them does not raise any competition law issues. If the market share is above this line, there is no presumption of lawfulness but a purchasing agreement among purchasers is not necessarily unlawful. It is subject to a variety of factors including the following:

First, whether or not a joint purchasing agreement promotes efficiency is an important consideration. To take a joint action vis-à-vis a foreign monopoly to mitigate the impact of high import prices would create efficiency. Also by engaging in joint purchasing, the purchasers may be able to aggregate significant demand. Offering this large demand may stabilize the international trade in the commodity in question and stimulate further development of natural resources in the exporting country.

Second, there is the question of whether such a joint purchasing agreement is essential to accomplish the purpose of creating a countervailing power to a foreign monopoly supplier. If there is an alternative way which is as effective as a joint purchasing agreement and which is less trade-restrictive, that way should be preferred.

Third, it is necessary to take precautionary measures so that the market power of the importers engaged in joint purchasing would not spill over to the downstream market, for example, to give assurances that, in the market in which products using the imported products are sold, prices of such products would not be unreasonably raised.

Fourth, it is important to avoid the situation where the import market is dominated by the purchasers/importers with market power and their competitors are squeezed out of importing the imported products.

Fifth, a competition policy concern would arise if the importers with market power in the import market tend towards collusive conduct in the downstream market. If the importers use the imported products to manufacture the final products which they sell to the downstream market, they may acquire sufficient information regarding each other's cost of production through jointly working in the imports. There may be other exchange of information on some sensitive items such as customers' lists, secret trade know-how, and development plans for new products. Although this is not illegal per se, it is a matter of concern to competition policy.

A preliminary ruling handed down by the European Court of Justice in 1994 suggests that the ECJ takes a similar position to the EU horizontal guidelines.[68] In this case, a Danish federation of farmers' cooperatives ('the Federation') was committed to purchasing fertilizers exclusively from foreign suppliers and prohibited each farmer's cooperative from independently negotiating and purchasing fertilizers from them. The Federation made a rule that only it could purchase fertilizers from foreign exporters and prohibited parallel buying of member agricultural cooperatives. Some cooperatives grew dissatisfied with this measure and engaged in parallel purchasing of fertilizers from foreign exporters. Thereupon the Federation imposed a disciplinary

[68] Judgment of the Court (Fifth Chamber) of 15 December 1994 *Gotrup-Klim e.a. Grovvar-foreigner v Dansk Landbrugs Grovvareselkab AmbA*—Reference for a preliminary ruling—Regulation No. 26/62—Cooperative purchasing association—Exclusion of members making parallel purchases—Infringement of Article 85 (1)—Abuse of a dominant position—Case C-250/92, European Court Report 1994, 05641.

measure on those cooperatives and expelled them from the Federation. Those cooperatives were expelled from the Federation but they could still use the Federation facility so this was not a total exclusion from participating in the activities of the Federation.

Those cooperatives brought a civil suit in a Danish court and argued that this restrictive measure caused damage to them, citing Article 85(1) and Article 86 of the Treaty of Rome (now TFEU Articles 101 and 102). The Danish court which handled this case referred the matter to the ECJ for a preliminary ruling on the legal point whether this exclusion amounted to a violation of Article 85(1) and Article 86.

The ECJ handed down a preliminary ruling that this arrangement did not infringe those Articles. The ECJ recognized first that this conduct was not covered by the EC Common Agricultural Policy (which would provide exemption from competition rules) and then stated that the conduct in question was undertaken to create a countervailing power to powerful foreign exporters and would benefit the member cooperatives by keeping prices lower than would otherwise be the case. In order to make this arrangement effective, it was necessary that the majority of cooperative members join the scheme and that no cooperatives buy fertilizers at a higher price in competition with the Federation. Also those cooperatives expelled from the Federation could still benefit from the joint purchasing arrangement and thus the scheme was not abusive.

The Court noted that the Federation had a market share of 36 per cent in the import market and this would constitute a dominant position in terms of Article 86 of the Treaty of Rome. It stated, however, that the conduct of the Federation did not amount to an abuse of dominant position because it was reasonable for the purpose of equalizing bargaining power and creating efficiency.

Although this decision was made before the EU Guidelines of 2011, there seems to be no conflict or inconsistency between this ruling and the principles enunciated in those Guidelines.

6. Competition Policy and International Cooperation in the WTO

Earlier in this chapter, an attempt was been made to show that there is much in common between competition policy and the principles of the WTO, that the transnational nature of business activities necessitates application of competition laws to activities abroad in some countries, and that there is a need for international cooperation with regard to the enforcement of competition laws in the face of the increasing globalization of business activities. This calls for a consideration of whether or not, and to what extent, the WTO can play a role in promoting international competition policy.

International cooperation in competition policy has been attempted in various international organizations such as the United Nations Conference on Trade and Development (UNCTAD) and the OECD. More recently a new framework for international competition policy called the International Competition Network (the ICN) was established.[69] In this network, enforcement agencies, academics, and private

[69] For information on the ICN, see <http://www.internationalcompetitionnetwork.org>.

practitioners in the field of competition policy meet regularly, exchange views, and coordinate policy-making and enforcement activities of the agencies of the members. This is not a binding agreement nor is there any permanent secretariat.

6.1 Competition policy agenda at the WTO

6.1.1 Activities of the working group on trade and competition policy in the WTO

WTO members established a Working Group on the Interaction between Trade and Competition Policy at the WTO Ministerial Conference held in Singapore in December 1996. The Singapore Ministerial Declaration states that an agreement was reached to establish a working group to study issues raised by members relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework. However, it adds that: 'It is clearly understood that future negotiations, if any, regarding multilateral disciplines in these areas, will take place only after an explicit consensus decision is taken among WTO Members regarding such negotiations'.[70]

The Working Group issued reports in 1997, 1998, 1999, 2000, and 2001.[71] In 1997 and 1998, the Group concentrated on issues listed in 'Checklist of Issues Suggested for Study' developed at the first meeting of the Group. The work centered on the following items in the Checklist:

- The relationship between the objectives, principles, concepts, scope, and instruments of trade and competition policy; and their relationship to development and economic growth.
- Stocktaking and analysis of existing instruments, standards and activities regarding trade and competition policy, including experience with their application.
- The interaction between trade and competition policy, including consideration of the following sub-elements:
  - The impact of anti-competitive practices of enterprises and associations on international trade;
  - The impact of state monopolies, exclusive rights, and regulatory policies on competition and international trade;
  - The relationship between the trade-related aspects of intellectual property rights and competition policy;
  - The relationship between investment and competition policy;
  - The impact of trade policy on competition.

[70] WTO, Ministerial Conference, Singapore, 9–13 December 1996, *Singapore Ministerial Declaration*, WT/MIN(96)/DEC, 18 December 1996, para. 20.

[71] WTO, Report (2000) of the Working Group on the Interaction between Trade and Competition Policy to the General Council, 30 November 2000, WT/WGTCP/4; WTO, Report (1999) of the Working Group on the Interaction between Trade and Competition Policy to the General Council, 11 October 1999, WT/WGTCP/3; WTO, Report (1998) of Working Group on Interaction between Trade and Competition Policy to the General Council, 8 December 1998, WT/WGTCP/2; WTO, Working Group on Interaction between Trade and Competition Policy—Report (1997) to the General Council, 28 November 1997, WT/WGTCP/1; Report (2002) of the Working Group on the Interactions between Trade and Competition Policy to the General Council, 8 October 2001, WT/WGTCP/5.

In December 1998, a detailed report was published on the Group's discussions on the above items. In 1999, the Group concentrated on the following three additional topics:

- The relevance of the fundamental WTO principles of national treatment, transparency, and MFN treatment to competition policy and vice versa;
- Approaches to promoting cooperation and communication among members, including in the field of technical cooperation; and
- The contribution of competition policy to achieving the objectives of the WTO, including the protection of international trade.

In the discussions of the Group, there was a consensus that WTO principles and competition policy were closely related to each other and would complement each other. There was a general agreement that cooperation among members in addressing anti-competitive practices needed to be enhanced. However, there was a diversity of views as to the need for action at the level of the WTO to enhance the relevance of competition policy to the multilateral trading system. Some members supported the development of a multilateral framework on competition policy in the WTO, the implementation of effective competition policies by members, and the reduction of the potential for conflicts in this area. However, others questioned the desirability of such a framework and favoured bilateral and/or regional approaches to cooperation in this field.

The next step would have been to introduce an agenda regarding a multilateral framework on competition policy to the Seattle Ministerial Conference. However, due to lack of consensus at the Seattle Ministerial Conference, this agenda was never submitted. In the WTO Ministerial Conference held in Doha in November 2001, members decided to initiate a negotiation of competition policy within the framework of the WTO if consensus could be achieved on the modalities of negotiation. This is touched upon below.

The Group continued to work on issues of trade and competition policy and, in December 2000, it published a report. The major areas covered in this report are largely the same as those in the 1998 and 1999 reports. However, there are a few additions. The report reflects deliberations of the members of the Group during the period 1999–2000 on: (1) the relevance of fundamental WTO principles of national treatment, transparency, and MFN treatment to competition policy and vice versa; (2) approaches to promoting cooperation and communication among members, including in the field of technical cooperation; (3) the contribution of competition policy to achieving the objectives of the WTO, including the promotion of international trade; and (4) other issues raised by members relating to the Group's mandate to study the interaction between trade and competition policy. As in the 1998 and 1999 reports, there was general agreement that the fundamental principles of the WTO (national treatment, transparency, and MFN treatment) are relevant to the cause of competition policy, but the views of members differed with regard to the ways in which the WTO should handle competition policy matters.

6.1.2 Review of the working group's reports

Numerous papers and so-called non-papers were submitted to the Group, and many oral presentations were made in the Group's discussions. In these papers and

presentations, a tremendous number of issues were taken up and a great diversity of views was expressed on major issues. It is not possible to take up every issue discussed nor is it necessary to do so. However, in the following paragraphs, we consider a few of the issues dealt with in the Group's discussions that seem most relevant to the purpose of this chapter.

6.1.3 Consensus

The similarity between the objective of the WTO (promotion of free trade) and that of competition policy is generally recognized. In fact, the whole scheme of the WTO is designed to establish the framework of free trade and guarantee the operation of the market mechanism in international trade. Competition policy is aimed at establishing and maintaining a free and open market. In this respect, the philosophical orientations underlying both are quite similar. It could probably be said that both are the same.

The basic principles of the WTO are: (a) MFN treatment; (b) national treatment; and (c) transparency. The first two boil down to the principle of non-discrimination. Non-discrimination is certainly an essential element in competition policy and is a cornerstone for free and open markets.

There is also a consensus that anti-competitive practices engaged in by private enterprises in international trade are harmful to the international trading system. Special mention is often made of the harmfulness of international cartels which divide markets of different trading nations, import cartels which restrict imports, export cartels which restrict exports, unreasonable exclusive dealing arrangements which limit market access, and an abuse of dominant positions in which a dominant enterprise excludes competing products from markets.

6.1.4 Divergent views

There are many divergent views on specific issues so we will merely give a few illustrations. Views regarding the relationship between antidumping and competition policy are diverse and sometimes opposed to each other. Some argue that competition policy and antidumping are designed to control unfair practices. On the other hand, there are views that antidumping is much easier to invoke than provisions in competition laws on predatory pricing. Whereas, in predatory pricing, one needs to prove not only below cost pricing but also the possibility that the wrongdoer is expected to recoup the loss that it incurs by below cost selling through the exercise of a market power that results from the predatory pricing, there is no such requirement either in the Anti-dumping Agreement or in domestic antidumping legislation. All that is required in antidumping is that there is a differential between export and domestic prices, that there is a material injury to a domestic industry, and that there is causation between the two. Some argue that it is a mistake to try to replace antidumping with competition policy since antidumping and competition policies are based on different objectives, have different constituencies, and are designed to serve different purposes.

Some suggest that, if trade barriers are substantially eliminated in international trade, there may be no need for antidumping legislation. They cite the example of

the trade agreement between Australia and New Zealand in which antidumping legislation was abolished with regard to the relationship between those two countries and was replaced by competition policy-type legislation.

There are many views and arguments regarding bilateral, regional, and multilateral trade agreements regarding competition policy. Although there are views that bilateral and regional arrangements on competition policy serve useful purposes, there are others who argue that bilateral and regional arrangements do not have sufficient geographical coverage and could provide advantages only to the participants.

Some developing countries argue that they need flexibility in the employment of their industrial policies for their economic development, and the imposition of a competition agreement in the WTO of a straightjacket type would be counter-productive to their economic development. They emphasize that there are differences in the degree of economic development and in competition culture among the members of the WTO, and any sensible international competition policy should take these into account.

Although there is no consensus (or convergence) of views as to whether there should be an international agreement on competition policy within the framework of the WTO, there are some striking features in many views expressed on this subject. The view that there should be a comprehensive international agreement on competition policy and law that is binding on members of the WTO is, at most, a minority opinion. Most members express the view that any comprehensive agreement on competition policy which binds all members of the WTO is still premature.

This point is expressed in the 2000 report: 'a number of delegations remained of the view that there was no need for any global rules on competition policy and/or that the call for a multilateral agreement might be too ambitious at the moment. It is difficult to consider multilateral rules in this area since, in the case of many developing countries, such rules could require revisiting and possibly re-designing laws which have only recently been adopted by legislatures'.[72]

It seems, therefore, that the main current of thought expressed in discussions of the Group is directed towards establishing a non-binding and 'soft law'-type agreement. This multilateral scheme of competition policy would include programmes such as technical assistance, notification of actions in competition law which would have some international implications, exchange of non-confidential information, and mutual cooperation in the enforcement of competition laws, including positive comity.

6.1.5 The Ministerial Declaration on Competition Policy adopted at the Doha Ministerial Conference in November 2001

The Ministerial Conference held in Doha, Qatar in November 2001 adopted the Ministerial Declaration in which WTO members agreed to initiate trade negotiations with a view to establishing new rules and clarifying existing rules. Three paragraphs of the Declaration are devoted to competition policy. The title of these paragraphs is

[72] WTO Report para. 88.

'Interaction between Trade and Competition Policy', and the section consists of paragraphs 23, 24, and 25:

> 23. Recognizing the case for a multilateral framework to enhance the contribution of competition policy to international trade and development, and the need for enhanced technical assistance and capacity-building in this area as referred to in paragraph 24, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations.
>
> 24. We recognize the needs of developing and least-developed countries for enhanced support for technical assistance and capacity building in this area, including policy analysis and development so that they may better evaluate the implications of closer multilateral cooperation for their development policies and objectives, and human and institutional development. To this end, we shall work in cooperation with other relevant intergovernmental organizations, including UNCTAD, and through appropriate regional and bilateral channels, to provide strengthened and adequately resourced assistance to respond to these needs.
>
> 25. In the period until the Fifth Session, further work in the Working Group on the Interaction between Trade and Competition Policy will focus on the clarification of: core principles, including transparency, non-discrimination and procedural fairness; and provisions on hardcore cartels; modalities for voluntary cooperation; and support for progressive reinforcement of competition institutions in developing countries through capacity building. Full account shall be taken of the needs of developing and least-developed country participants and appropriate flexibility provided to address them.

Paragraph 23 states that 'we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations'. The initiation of negotiation on competition policy therefore depends upon an explicit consensus regarding modalities of negotiations. The meaning of 'modalities' is not clearly spelled out, and there is ambiguity with regard to the exact meaning of this term. If 'modalities' is defined broadly to include some substantive issues such as whether an agreement on competition should be binding and mandatory and what types of anti-competitive conduct should be made the subject matter of the agreement, difficulty in reaching consensus should be expected. In light of this, whether there will be future negotiations on competition policy is uncertain.

Paragraph 24 stresses the important of capacity-building in competition policy matters for developing and least developed countries. Capacity-building for developing and least developed countries is the thread which runs through the Doha Ministerial Declaration, and programmes for capacity-building will be made and carried out in many WTO matters, including competition policy. Therefore, it is likely that some form of agreement will be reached for the promotion of technical assistance and capacity-building for developing and least developed countries in competition policy.

Paragraph 25 declares that, in the meantime, the Working Group on the Interaction between Trade and Competition will be engaged in the study of core issues, including transparency, non-discrimination, and procedural fairness, provisions on hardcore cartels, modalities for voluntary cooperation, and support for progressive reinforcement of competition institutions in developing countries through capacity-building.

In future, if the WTO undertakes a project to incorporate an agreement on competition within its regime, likely candidates for consideration will be such items as transparency, non-discrimination, and procedural fairness, modalities for voluntary cooperation, and support for progressive reinforcement of competition institutions in developing countries through capacity-building.

Divergent views may be anticipated regarding what are 'hardcore cartels', and whether or not they should be limited to international cartels (export and import cartels) which affect international trade directly, or should also include domestic cartels.

However, at present, there is little prospect of comprehensive negotiation on a new agreement on competition policy taking place in the WTO. So the above suggestions will be for future generations to take forward.

7. Concluding Remarks

At a WTO Ministerial meeting in Geneva in 2004, it was decided that the Singapore Issues including competition policy would be dropped from the items of negotiation of the Doha Developments Round. Therefore, the issue of whether to introduce a competition policy agreement within the framework of the WTO will not be considered for some time. However, since competition policy issues are essential to the smooth operation of the WTO system, it seems that competition policy issues will continue to make an appearance in international negotiations at the WTO and at bilateral, regional, or plurilateral FTAs. In future negotiations, the results of discussions in the Working Group will serve as useful references for this purpose.

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