Economics, Law, and Institutions in Asia Pacific

Mitsuo Matsushita
Thomas J. Schoenbaum *Editors*

Emerging Issues in Sustainable Development

International Trade Law and Policy Relating to Natural Resources, Energy, and the Environment

Economics, Law, and Institutions in Asia Pacific

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Editors

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International Trade Law and Policy Relating to Natural Resources, Energy, and the Environment

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ISSN 2199-8620 ISSN 2199-8639 (electronic)
Economics, Law, and Institutions in Asia Pacific
ISBN 978-4-431-56424-9 ISBN 978-4-431-56426-3 (eBook)
DOI 10.1007/978-4-431-56426-3

Library of Congress Control Number: 2016954076

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Printed on acid-free paper

This Springer imprint is published by Springer Nature
The registered company is Springer Japan KK
The registered company address is: Chiyoda First Bldg. East, 3-8-1 Nishi-Kanda, Chiyoda-ku, Tokyo 101-0065, Japan

Preface

Natural Resources, International Trade, and Sustainable Development

Natural resources include the raw materials mankind derives from the functioning ecosystems of the planet Earth as well as the products and services that are derived from them. Natural resources include a wide variety of entities and products, such as metals, water, fossil fuels, and biological products of many kinds. Natural resources are essential to the economic and spiritual well-being of mankind and life on Earth.

There are three special reasons why we should give particular attention to natural resources. First, what we call natural resources are part and parcel of the Earth's functioning ecosystems, which are essential to life on Earth. Second, natural resources provide mankind with what scientists call "ecosystem services"—things we take for granted, such as water for our needs, protection for our coastal lands, and supplies of fish and other products. Third, natural resources are inherently limited; we must take care to use them wisely.

For the foregoing reasons, what we now call "sustainable development" is very important when dealing with natural resources. Sustainable development, briefly stated, is the use of natural resources with a view of preserving essential natural resources for future generations. Sustainable development is a concept that permits economic growth and use of resources but mandates the wise usage of resources to ensure their future availability. When we consider the scope of application of sustainable development applied to our political and economic systems, we may divide sustainable development into two levels: domestic sustainable development and sustainable development at the international level.

This work covers sustainable development of natural resources from the viewpoint of the multinational trading system. Natural resources of all kinds move in international trade. Moreover, states are situated differently with respect to natural resources: some states are rich in certain natural resources, while other states are

resource-poor. Under these circumstances, it is essential to maintain robust international trade and investment in natural resources.

Nevertheless, the conservation of natural resources is essential both at the domestic and international levels. In addition, there must be correlation between domestic conservation on the one hand and international conservation measures on the other. The key question is how to achieve this conservation.

This book attempts to provide an answer to this question by considering multiple facets of international conservation of natural resources. As editors, we have divided the book into eight sections to correspond with eight facets of international conservation of natural resources. Eminent scholars from many different countries address these eight different areas of policy.

In Part I of this book, we examine the domestic legal regimes for the conservation of natural resources in two key countries, Australia and China. Unsurprisingly, because these two nations have very different political and legal systems, their conservation laws and policies provide a rich contrast. While Australia has many longstanding conservation policies in place, the conservation of natural resources in China is still an evolutionary project.

Part II analyzes in detail what is perhaps the most important aspect of international sustainable development of natural resources—the rules of the multinational trading system administered by the World Trade Organization (WTO). We find that the WTO rules on export restrictions relating to natural resources are ambiguous and controversial. While the WTO historically has been concerned with import measures in international trade and access to markets, the export side of trade which is crucial to the conservation of natural resources has been neglected to the point that the rules are not only ambiguous but are unfair. We call for reform of WTO export rules to correct this unfairness.

Part II also analyzes in detail the general exceptions of the WTO General Agreement on Tariffs and Trade from the point of view of conserving natural resources. The analysis of these general exceptions is particularly aided by the fact that the WTO dispute settlement system has handled two important cases concerning the conservation of natural resources: the *China Rare Earths Case* and the *China Mineral Export Case*. The analysis in this book outlines both deficiencies and strengths of the general exceptions as applied to natural resources.

Part III of this book deals with the role free trade agreements play in the trade and investment of natural resources. Free trade agreements are proliferating all over the globe. Every WTO member is now a party to multiple free trade agreements. Such agreements may in the future supplant the WTO rules relating to natural resources in whole or in part. It is important to consider the role that they play now as well as their possible future role.

Part IV considers competition law and its role with respect to the conservation of natural resources. Many nations, including the United States, the European Union, and Japan, now apply their competition laws extraterritorially to affect other countries. Competition laws must consider sustainable development policies as well as traditional economic concerns with respect to natural resources.

Part V deals with special international agreements concerning certain types of natural resources. The chief exemplar of a special agreement is the Energy Charter Treaty, which this section analyzes in detail.

Part VI concerns the important issue of subsidies of natural resources and the role international trade and investment law plays in either encouraging or discouraging such subsidies. The issue of subsidies is complex. On the one hand, subsidies may be crucial to the development of renewable energy and other policies with respect to sustainable development of natural resources. On the other hand, subsidies may encourage overuse of natural resources that is detrimental to sustainable development.

Part VII covers international investment law and its relationship to the sustainable development of natural resources. International investment law is increasingly dominated by bilateral investment treaties and investor-state arbitration. In this section, we advocate that sustainable development principles be included in the norms that international tribunals apply in investment dispute cases.

Part VIII deals with emerging environmental issues concerning climate change and advocates legal policies that work in harmony with the global effort to stem climate change.

In summary, this book offers readers a wide-ranging menu of considerations relating to the sustainable development of natural resources in international trade and investment.

Tokyo, Japan Mitsuo Matsushita
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Part I
Law and Policy on Natural Resources in Selected Asian Countries

Chapter 1
Natural Resources and Energy Regulation in Australia: The Energy White Paper in Context

Andrew D. Mitchell and Jessica Casben

Abstract The fragmented and complex nature of the regulation of resource exploration, extraction and production in Australia, coupled with the seemingly constant changing face of Australian politics in recent years, poses unique challenges for policy makers and industry alike, despite relatively free and open trade in natural resources. Addressing the nation's energy security needs means balancing Australia's interests as a major global energy exporter against domestic consumption requirements and pricing pressures while securing long-term energy sustainability. Australia's current energy policy agenda, recently outlined in the federal government's Energy White Paper, attempts to strike this balance, but does more in the way of demonstrating the challenges than addressing them.

Keywords Australia • Energy security • Natural resources • Regulation • Trade

1 Introduction

Boasting some of the world's largest economic resources of minerals and significant potential in its renewable resources, Australia's abundant wealth in natural resources is difficult to overstate. With an absence of export controls or other trade restrictions, trade is relatively free and open, limited only by market demand and production capacity.

Give the value of this trade to Australia's economy, the challenges it faces—as a result of high international prices and increasing domestic energy consumption, as

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This article was produced with research funding from the Australian Research Council (Discovery Project scheme, project ID DP130100838) pursuant to a grant to conduct independent research on safeguarding regulatory autonomy in Australia's Preferential Trade Agreements and Bilateral Investment Treaties. The views expressed in this chapter are the authors' own and are not necessarily shared by any government, employer or other entity.

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© Springer Japan 2016

M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_1

well as diminishing reserves in crude oil—make securing Australia's long-term energy security a fine balancing act of policy. That is, balancing Australia's interests as a major global energy exporter, entailing dependence on traditional fossil fuels for continued economic growth, against domestic consumption requirements and pricing pressures while securing long-term energy sustainability through increasing reliance on renewable energy technologies. Australia's current energy policy agenda, recently outlined in the federal government's Energy White Paper,[1] attempts to strike this balance, but does more in the way of demonstrating the challenge than addressing it.

2 Australia's Natural Resource Profile

Australia has a rich abundance of natural resources across mineral and agriculture sectors, as well as significant potential in renewable energy. Australia's diverse mineral endowment is reflected in its global rankings.

Australia is the largest producer of bauxite and the second largest producer of gold in the world, has the largest natural gas reserves in the Asia-Pacific region, and holds some of the world's largest deposits of iron ore.[2] In addition, Australia hosts the largest endowment of uranium resources in the world, accounting for 31 % of the global total.[3] As a percentage of total capital, in 2000 Australia's natural resources endowment was ranked fourth in the OECD behind Norway, Canada and New Zealand (excluding agriculture).[4]

Australia also boasts strong potential in the field of renewable resources. With some of the highest solar radiation levels per square metre in the world, solar power prospects are promising,[5] and increasing opportunities are being identified in respect of wind, geothermal, wave and tidal energy sources.[6] While these technologies are employed to a limited degree domestically, they are not the subject of trade.

Despite being the world's fifth largest producer of rare earth minerals and hosting the world's third largest resources, current production of rare earth minerals in Australia is limited to a single mine, Mount Weld in Western Australia.[7]

[1] Commonwealth of Australia, Department of Industry and Science (2015).

[2] Commonwealth of Australia, Geoscience Australia, *Iron Ore*.

[3] Minerals Council of Australia, *Australia's Uranium Industry*.

[4] Boulhol H, de Serres Aand Molnár M (2008) at pg 34.

[5] Commonwealth of Australia, Geoscience Australia and ABARE (2010) at pg 21.

[6] Commonwealth of Australia, Bureau of Resources and Energy Economics (BREE) (2014) at pgs 19–22.

[7] Department of Industry, Innovation and Science.

3 Regulation of Natural Resources in Australia

Australia operates under a federal system of government that sees regulatory authority divided between the central federal government and several regional state and territory governments. Pursuant to the Australian Constitution,[8] the federal government's responsibilities include taxation; export controls; the examination and approval of foreign investment proposals; and native title. The Commonwealth is also responsible for regulating environmental matters of national significance. States and territories, on the other hand, have responsibility for mineral leases and operations; most environmental assessments, approvals and regulation; water regulation; regional planning; infrastructure; and education and training. In the case of natural resource exploitation, Federal and state and territory regulation of environmental matters overlaps considerably. In addition, local governments handle the provision of services as well as local planning and approvals.

This patchwork of regulation not only creates a complex system of interrelationships, which can lead to uncertainty in the sector, but also contributes to the financial and time burdens placed on industry activity. In effect, the operation of the federal system means that various laws, imposing different obligations, can apply to a single company depending on the location of its operations. It has been noted that major projects sometimes require in excess of 70 different primary and secondary approvals, licences, permits and authorisations across various government departments and levels.[9] The resulting inefficiencies, inconsistencies and increased costs are regularly the subject of complaint and calls for reform by the resources industry.[10]

3.1 Federal Regulation

While the federal government's responsibilities are not directly targeted at trade in natural resources, several of its functions impact directly on industry operations in the area.

3.1.1 Export Controls

Australia maintains export controls in respect of only two products, both natural resources. The export of rough diamonds and uranium is restricted in line with Australia's international commitments.

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[8] *Commonwealth of Australia Constitution Act 1900*, s51.

[9] Commonwealth of Australia, Department of Industry and Science (2015) at pg 48.

[10] Minerals Council of Australia (2014) *Minerals industry priorities for regulatory reform.*

The export of rough diamonds is restricted to countries participating in the Kimberley Process Certification Scheme (KPCS), a joint initiative between governments, industry and civil society aimed at curbing trade in conflict diamonds. In essence, export is prohibited except to a KPCS country participant, in a tamper-resistant container and accompanied by a Kimberley Process Certificate certifying that the product is from legitimate sources, and not involved in funding conflict.[11]

Similarly, export of uranium and related nuclear materials must comply with Australia's non-proliferation obligations. Australia's export policy requires that Australian uranium is exported only for peaceful non-explosive purposes pursuant to bilateral nuclear cooperation agreements, which mandate International Atomic Energy Agency (IAEA) and fallback safeguards as well as physical security requirements.[12] Australia currently has 23 nuclear cooperation agreements, covering 41 countries.[13] Australia entered the most recent of these with India in late 2015, an agreement expected to double the size of Australia's nuclear mining sector.[14]

3.1.2 Foreign Investment

With 35 % of total foreign investment in Australia in the mining sector, the foreign investment framework is a key feature of natural resources regulation. Australia's foreign investment framework[15] requires certain proposed investments to be notified to the Foreign Investment Review Board (FIRB). Notification requirements vary as between investors and acquisitions and are also informed by Australia's commitments under free trade agreements. Notified investments are subject to review by FIRB, which considers issues such as national security and competition, as well as economic, community and environmental impacts. Ultimately, the notification and review process operates to allow the Australian Treasurer, as advised by FIRB, to block proposals that are contrary to the national interest or apply conditions on proposals to ensure the national interest is met.[16]

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[11] *Customs (Prohibited Export) Regulations 1958* (Cth), Regulation 9AA.

[12] Commonwealth of Australia, Department of Foreign Affairs and Trade, *Australia's Uranium Export policy*.

[13] The Parliament of the Commonwealth of Australia (2015) *Report 151 Treaty tabled on 28 October 2014 Agreement between the Government of Australia and the Government of India on Cooperation in the Peaceful Uses of Nuclear Energy* at pg 64.

[14] Ibid. at pg 13.

[15] The framework is comprised of four pieces of legislation: *Foreign Acquisitions and Takeovers Act 1975*, *Foreign Acquisitions and Takeovers Regulation 2015*, *Foreign Acquisitions and Takeovers Imposition Fees Act 2015* and the *Register of Foreign Ownership of Agricultural Land Act 2015*.

[16] *Foreign Acquisitions and Takeovers Act 1975*, s67.

In December 2015, the FIRB framework underwent its first comprehensive review since 1975.[17] The result saw the introduction of application fees on investment proposals ranging from $5,000 to $100,000, as well as an increase in criminal penalties. Notification thresholds were increased in most sectors from 15 % to 20 % but decreased in respect of agricultural land and agribusiness.[18] The review also saw the introduction of exemption certificates in respect of land acquisitions, including mining and production tenements.[19] If granted, exemption certificates operate to exempt one or a number of investments from the notification process. They are intended avoid the need for foreign investors with a high volume of land acquisitions to notify each acquisition separately, instead facilitating up-front approvals for the notified program of acquisitions.[20]

Foreign investment in mining or production tenements—broadly defined to include investment in mining leases and licences and petroleum production leases, as well as leases and other rights to recover minerals, oil or gas, and even receipt of profits—attract particular rules. Most significantly, no thresholds apply–all investment proposals are notifiable except as provided for under a negotiated trade agreement. Investors from these countries are only required to notify investments over $1094 million. Currently, the only countries that benefit from a negotiated threshold are the United States, New Zealand and Chile, pursuant to free trade agreements currently in force.[21] The recent conclusion of the *Trans-Pacific Partnership Agreement* (TPP)[22] would see the $1,094 million threshold apply to all TPP countries,[23] should Australia ratify the agreement. This would see the higher threshold extended to investors from Brunei, Canada, Japan, Malaysia, Mexico, Peru, Singapore and Vietnam. Exploration activities are not captured within the mining and production definitions, but investments may still require notification if they involve other acquisitions, such as of agricultural or commercial land.[24]

Particular rules also apply to investments made by foreign governments. A foreign government investor is defined to include foreign governments and their

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[17] Allens Linklaters (2015) at pg 2.

[18] Commonwealth of Australia, Foreign Investment Review Board (2015) *Foreign Investment Reforms Factsheet*: *Reform overview*.

[19] *Foreign Acquisitions and Takeovers Act 1975*, Division 5.

[20] Commonwealth of Australia, Foreign Investment Review Board (2015) *Guidance Note 21 Exemption Certificates for a Program of Acquisitions of Interests in Kinds of Land*.

[21] *Australia–United States Free Trade Agreement* (AUSFTA), signed 18 May 2004, in force 1 January 2005. *Australia–New Zealand Closer Economic Relations Trade Agreement* (ANZCERTA), signed 28 March 1983, in force 1 January 1983. *Australia-Chile Free Trade Agreement* (ACIFTA), signed 30 July 2008, in force 6 March 2009.

[22] *Trans-Pacific Partnership Agreement* (TPP), not yet signed, not yet in force.

[23] TPP, Chapter 9, Annex I–Australia. See also, Department of Foreign Affairs and Trade (2015) *Trans-Pacific Partnership Agreement Fact Sheet*, *Outcomes*: *Resources and Energy*.

[24] Allens Linklaters (2015) at pg 8.

separate agencies, corporates, trusts and limited partnerships, subject to certain interest thresholds.[25] The tracing mechanism[26] that applies to the definition means that independently operated commercial investors can be treated as foreign government investors even with only distant government engagement.[27] Not only are foreign government investors subject to more rigorous screening than private investors but, as a general rule, no monetary thresholds apply to foreign government investors in respect of: any acquisitions of a direct interest in an Australian entity; starting an Australian business; a mining, production or exploration tenement; or at least 10 % in securities in a mining, production or exploration entity.[28] This means that all such acquisitions must be notified and approved.

3.1.3 Native Title

Australian law recognises and protects Aboriginal and Torres Strait Islander peoples' traditional connection to land through the native title framework. Under the *Native Title Act 1993*, native title claimants can make an application to the Federal Court of Australia to have their native title recognised by Australian law. Native title can include rights of possession, occupation, and use and enjoyment of traditional country, differing between groups and areas based on the particular claims made. Native title can co-exist with other rights but cannot be bought or sold; it can, however, be surrendered or acquired by government for compensation.[29]

As a general rule, native title no longer exists in relation to freehold land, leases providing for exclusive possession, or construction of public works,[30] but can persist over Crown land. The relevance of native title to natural resource operations is clearly illustrated in Western Australia, a key player in terms of natural resource wealth, of which 93 % of the state remains Crown land.[31] In addition, native title is not extinguished by pastoral or mining leases and can co-exist with these rights.[32]

Where access to natural resources is sought over land that is subject to native title, the process requires negotiation between the proposer, native title holders, and relevant state or territory on issues including payment, employment, and the protection of important sites. In the absence of agreement, the National Native Title Tribunal will determine whether a compulsory acquisition can occur.[33] The

[25] *Foreign Acquisitions and Takeovers Regulation 2015*, s17.

[26] *Foreign Acquisitions and Takeovers Regulation 2015*, s48.

[27] Jones D, Gilbert and Tobin Lawyers (2015).

[28] *Foreign Acquisitions and Takeovers Regulation 2015*, s56.

[29] Federal Court of Australia (2015).

[30] See, *Native Title Act 1993*.

[31] Government of Western Australia, Department of Crown Lands (2013).

[32] Re. mining coexistence see *Western Australia v Brown* [2014] HCA8.

[33] See, *Native Title Act 1993* ss35, 38–39.

recognition of native title in Australia is ongoing, with new claims continuing to be made in respect of land. As a result, simply because land is not currently designated as subject to native title does not mean that native title interests don't apply to it.

3.1.4 Environmental Regulation

Although considerable responsibility for environmental management rests with the Australian states and territories, the federal government has responsibility for matters of national environmental significance. The *Environment Protection and Biodiversity Conservation Act 1999* (the EPBC Act)[34] details the federal framework for the management and protection of these matters, which include the protection of nationally important flora, fauna, ecological communities and heritage places and the implementation of Australia' international environmental responsibilities.[35] Any action that could have a significant impact on such a matter must be referred to the federal Minister for the Environment.[36]

Assessments of proposals under the EPBC Act will differ depending on the proposed action but will involve public notification and commentary.[37] When deciding if a proposed action should be approved and under what conditions, the Minister has broad discretion to consider any relevant information on the impacts of the proposed action but must take into account: the principles of ecologically sustainable development, including the precautionary principle, as well as the balancing of economic, social and environmental considerations; the results of the assessment of the impacts of the proposed action; and community and stakeholder comments, among others.[38]

Large scale mining operations will generally be referred to the Minister and, following 2013 amendments to include a water impact trigger,[39] so will coal mining or coal seam gas extraction that have a significant impact on water resources.

3.2 State and Territory Regulation

Compared to federal regulation in the resources sector, state and territory regulation sits at a more practical, operational level. State and territory governments and their agencies are responsible for granting exploration and mining tenements, regulating

[34] *Environment Protection and Biodiversity Conservation Act 1999* (EPBC Act).

[35] EPBC Act, s3.

[36] EPBC Act, s69 and Part 3.

[37] EPBC Act, s74(3).

[38] EPBC Act, s136.

[39] Commonwealth of Australia, Department of the Environment *Water resources – 2013 EPBC Act amendment – Water trigger*.

mining operations in respect of health and safety standards, and setting and collecting mining royalty payments and licence fees.

At the most fundamental level, ownership of Australia's minerals vests with the relevant state or territory by operation of reservations in grants and statute.[40] For this reason it is the state and territory governments that regulate access to these natural resources. Where land is privately owned, restrictions will usually require payment of compensation for damage to land and any access restrictions. In some states, including Victoria, South Australia and Western Australia compensation is also payable for loss of use of land, including amenity, loss of earnings, and social disruption.[41] Where the land is Crown land, restrictions will apply based on the status of the land in question and approval from the relevant Minister will likely be required.[42] Where native title claims exist in respect of Crown land, Federal regulation applies (see 3.1.3 above).

Access and exploitation will also come at a cost set by the relevant jurisdiction. Payment usually includes two components: annual rental payments for access to the land; and resources and royalties on minerals extracted. Rates payable differ between states and as between different products.[43] Operations in the resources sector also attract other liabilities including tax and other duties, including income tax, company tax and Goods and Services Tax (GST) as well as stamp duty. However, these liabilities are generally applicable to corporate and business operations rather than being unique to the resources sector.

Environmental approvals, prior to commencement of exploration or production works, are also in the purview of state and territory governments under their own legislative frameworks. Environmental assessments include consideration of: air, water and land use and impacts; noise effects; the protection needs of flora, fauna and habitat; and any impact to objects or sites of significance to indigenous communities. A variety of terms and conditions are likely to be imposed on a project. For large scale operations, referral to the federal government, under the EPBC Act, is also likely (see 3.1.4 above).

States and territories also require oversight of resource exploration and production operations. In the case of large scale resources projects, this is often achieved through ratified agreements[44] between the relevant state or territory government and the industry proposer. These agreements are contracts detailing the framework for the development and operation of a specific project that are ratified by an act of Parliament. The ratification step means that the agreements themselves have

[40]See, for example, *Mineral Resources Development Act 1990* (Victoria), s9; *Mining Act 1971* (South Australia), s16.

[41]See, for example, *Mineral Resources Development Act 1990* (Victoria), s85; *Mining Act 1971* (South Australia), s61, and *Mining Act 1978* (Western Australia), s123.

[42]See, for example, *Mineral Resources Development Act 1990* (Victoria), s44; *Mining Act 1978* (Western Australia), Part III, Division 1.

[43]Bowie C, Minter Ellison (2010).

[44]Sometimes referred to as State Agreements or Government Agreements.

legislative effect and override any inconsistencies with other legislative instruments,[45] it also means that the rules that apply to large scale mining operations in a given state or territory will unlikely be understood by simple reference to the overarching legislation, and will require recourse to the ratified agreements in place.

3.2.1 Case Study: Queensland

The volume and complexity of Australia's natural resource regulation is not simply a function of the federal structure. Queensland, a state with significant resources and operations, is recognized as having some of the most lengthy mining, petroleum and energy resources legislation in the developed world. Comparing itself to Alberta, Canada, a similar jurisdiction in terms of size and mining industry complexity, the Queensland Government has stated that Alberta has only 27 % of Queensland's regulatory volume.[46]

One of the main drivers of this complexity and bulk is that the current administration system has separate legislation for minerals and coal, and petroleum and gas, as well as additional legislation developed to deal with new industries such as geothermal and greenhouse gas storage.[47] In response to concerns that the regulatory system is preventing the Queensland resources industry from capitalising on a globally competitive resources environment and limiting its attractiveness to investors, the Queensland government has set in place a regulatory program to streamline the regulatory process and capture it in one unified, harmonised piece of legislation.

The proposal involves a shift from the "overly prescriptive" principles based approach to an outcomes based approach, involving greater flexibility and responsiveness in work plans. It also introduces a flexible self-assessment approach to exploration performance, whereby proponents manage and review their activities in comparison with their stated objectives as well as caps and default terms on exploration to provide for greater certainty.[48]

The intention is that the reforms will "provide the necessary inducement to attract capital into resources exploration in Queensland to enable more discoveries and allow for production sooner"[49] and thereby increase investment in exploration and improve knowledge of resource potential, among other things. The reforms offer a good illustration of Australia's "open for business" approach to regulation of and trade in natural resources, which seeks to make it easier for business to access and operate in the natural resources market.

[45] Fitzgerald A (2001) at pgs 33–34.

[46] Queensland Government, Department of Natural Resources and Mines (2014).

[47] Ibid.

[48] Queensland Government, Department of Natural Resources and Mines (2015).

[49] Ibid. at pg 5.

4 Trade in Natural Resources

Trade in natural resources is vital to the Australian economy and growth in the sector has been strong in recent years. However, despite Australia's strong performance in export trade, Australia is still reliant on imports to satisfy domestic energy consumption.

4.1 Exports

As the world's second largest exporter of coal, third largest exporter of uranium, and fourth largest exporter of gas, Australia has a strong history as a major exporter of natural resources. The value of natural resources to the Australian economy is significant and largely realised through this export trade. The minerals industry alone is Australia's largest export earner, accounting for up to 60 % of the annual value of total exports of goods and services. Metals including iron ore and gold make up 28 % of total exports, with coal accounting for a further 18 % and oil and gas 9 %. In 2013–2014, exports from this sector accounted for 7 % of GDP and $71.5 billion in export earnings.

Growth in the sector is strong, with the value of mineral exports, excluding oil and gas, increasing from $45.9 billion to $145.6 billion between 2002–2003 and 2012–2013.[50] This growth has been accredited both to increasing commodity prices and production and the "shock" attributable to rapidly increasing demand from China.[51]

The greatest demand for Australia's natural resource exports comes from Asia, in particular China, India, Japan and South Korea. The increasing demand from this region in recent years has been so strong that rhetoric has shifted, with Australia's "tyranny of distance" from Europe now being touted as its "power of proximity" to Asia.[52] However, while the mining sector is expected to continue to grow, policymakers caution that Australia's openness to foreign trade and investment will be critical in ensuring success.[53]

4.2 Imports

Despite its position as a net energy exporter, Australia is also a significant importer of crude oil. In response to falling production of crude oil (due to a number factors,

[50] Commonwealth of Australia, Geoscience Australia, *Australia's Identified Mineral Resources*.

[51] Parkinson M (2012).

[52] Commonwealth of Australia, Department of the Prime Minister and Cabinet (2012) at pg 1.

[53] Parkinson M (2012).

including rising production in Asia and exhaustion of mature oil fields), Australia is increasingly relying on imports to meet domestic consumption needs.

This places Australia in an interesting position as both importer and exporter of crude oil. Oil is the largest source of energy in Australia, accounting for 38 % of primary energy consumption. To put this into context, in 2012–2013 coal accounted for 33 % of domestic energy consumption, natural gas 24 % and renewable energy 6 %. However, as a result of rising domestic consumption being met with declining domestic production resulting from declining production capacity and maturity of known resources,[54] Australia is increasingly relying on imports to satisfy domestic demand. In 2013–2014, imported crude oil met 44 % of domestic consumption.[55] Nevertheless, Australia still exports 75 % of production because the crude oil produced is incompatible with existing infrastructure in domestic refineries.[56]

5 Energy Security

Ensuring Australia's energy security requires striking a fine balance between domestic and export demands and between traditional reliance on fossil fuels and future capabilities in renewable energy sources. While Australia's domestic consumption of gas is declining, its production is increasing and finding success in new export markets. On the other hand, while domestic consumption of crude oil increases, domestic production declines, leading to an increasing reliance on imports. All this against a backdrop that sees Australia's economic prosperity driven in no small part by the traditional energy and natural resources sector, which is expected to attract export earnings in the range of $114 billion in the next 5 years.[57]

In its recently released Energy White Paper, setting out the federal government's energy policy framework, the government made clear that it sees increased trade and investment in energy resources as key to Australia's energy security. In particular, the government has given priority to reducing unnecessary regulatory burdens, complex government approvals and duplication across jurisdictions in the resources sector, working toward the "guiding principle [that] markets should be left to operate freely, without unnecessary government intervention."[58] The role for future-proofing Australia's energy needs in the renewables sector is unclear.

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[54]Commonwealth of Australia (2015) *Australia's transport energy resilience and sustainability* at paras 2.22–2.26.

[55]Commonwealth of Australia, Department of Industry and Science (2015) at pgs 26–27.

[56]Commonwealth of Australia (2015) *Australia's transport energy resilience and sustainability* at para 2.17.

[57]Commonwealth of Australia, Department of Industry and Science (2015) at Minister's Foreward.

[58]Commonwealth of Australia, Department of Industry and Science (2015) at pg i.

5.1 Natural Gas

Australia's gas markets are changing rapidly. With the development of coal seam gas extraction and the commencement of gas exports from Eastern Australia, supply is now directed at both the domestic and international markets. As a result, domestic prices are now rising to meet high international prices. This presents opportunities for exporters and the economy, particularly in light of declining domestic gas demand,[59] but also contributes to pricing and supply pressures for domestic consumers.[60]

5.1.1 Coal Seam Gas

Australian gas production has historically come from conventional gas resources. Production in coal seam gas, however—an unconventional gas source that is extracted using a variety of technologies including vertical, horizontal or directional drilling or hydraulic fracturing (fracking)—has more than doubled in the past 3 years and currently makes up 12 % of national production.[61] While coal seam gas is typically more costly to extract than conventional gas, high international prices have made it a profitable endeavour, although this has continued to fuel domestic price rises.[62]

Although Queensland's experience in developing a new gas export industry, built on the back of coal seam gas production, has brought in over $63 billion in direct investment, extraction of coal seam gas has been resisted in some areas. Community and environment groups have expressed concern about the risk of contaminated water supplies resulting from fracking, a process that is often used to stimulate the flow of coal seam gas. As a result, the Victorian government placed a moratorium on coal seam gas extraction and fracking from August 2012 until a review of the regulatory framework had been undertaken.[63] This was then extended to July 2015, covering all onshore gas exploration.[64] On the other hand, following a 12 month moratorium and related review into fracking, the NSW government lifted

[59]Forcey T, Melbourne Energy Institute (2015) at pgs 13–14.

[60]Commonwealth of Australia, Department of Industry and Science (2015) at pg 17.

[61]Commonwealth of Australia, Bureau of Resources and Energy Economics (BREE) (2014) at pgs 17 and 84.

[62]Wood T, Grattan Institute (2014) at 8.

[63]O'Brien M (2012).

[64]Napthine D (2013). The Final Report was tabled on 8 December 2015 on the issues of the moratorium the Committee was unable to reach a majority decision.

the moratorium in favour of a Code of Practice[65] and a ban on the use of BTEX chemicals in fracking.[66]

The federal government has labelled such policies "unnecessary regulatory and planning barriers and moratoriums" and attributed to them at least some of the pricing and supply issues facing the domestic market. It has not, however, addressed the public concerns about the safety and environmental risks of coal seam gas extraction, promoting instead "better community engagement" and the role of government-funded science organisations. Currently, neither the state and territory moratoria nor the federal government's policy outlook do much to resolve the concerns of gas developers, land owners or environmentalists or relieve supply or cost pressures.[67]

5.1.2 Natural Gas Reserve

Domestic consumers of gas have been facing steadily rising prices, with a 36 % rise in the 5 years to 2013.[68] Partly attributable to increasing gas distribution and retailing costs,[69] this price rise also reflects the domestic market moving towards parity with international prices. Gas consumption and prices in two of Australia's largest markets, China and Japan, have been increasing in recent years, with the result that domestic gas prices are competing with these higher international prices.

In response to these pressures, a number of stakeholders, including industry groups, miners and unions, have called for a national gas reservation policy that reserves supply for domestic consumption. One such reserve currently operates in Western Australia, where government policy requires LNG producer exporters to reserve 15 % of gas for domestic use.[70] A similar policy exists in Queensland, although it is not currently applied.[71]

The federal government has responded directly to these calls in the Energy White Paper, stating unequivocally that "a Gas reservation is not supported by the Australian Government [as it] would have negative consequences for the economy",[72] with the Minister for Industry and Science going so far as to call the idea "ideological claptrap".[73] The government's position is that a reserve

[65]New South Wales Government (2012) *Code of Practice for Coal Seam Gas Fracture stimulation activities.*

[66]New South Wales Government (2012) *Ban on use of BTEX compounds in CSG activities*, Policy # TI-O-120.

[67]Wood T, Grattan Institute (2014) at pg 9.

[68]Ibid. at pg 11.

[69]Forcey T, Melbourne Energy Institute (2012) at pg 12.

[70]Government of Western Australia (2012) at pg 14.

[71]*Petroleum and Gas* (*Production and Safety*) *Act 2004*, s175C.

[72]Commonwealth of Australia, Department of Industry and Science (2015) at pgs 19–20.

[73]Orchison K (2014).

essentially acts as a tax on production and by reducing profits, in turn, attracts less investment and results in reduced gas supply. Instead, the government's primary response to high prices is to ensure diverse suppliers and encourage additional supply.[74]

The government's position has found support from an independent think tank arguing that reserving gas for domestic production subsidises domestic manufacturers and households in much the same way as tariffs once protected Australian industries, encouraging inefficient industries and reducing competiveness.[75] Concerns have also been raised about the impact of a reserve on renewable energy, with arguments that artificially low gas prices would make energy from alternative sources, such as renewables, less competitive.[76]

5.2 Nuclear Production

Despite Australia's strong global position as a producer of uranium, it has no electricity generation from nuclear power. While significant infrastructure could support a nuclear power program, including the Australian Nuclear Science and Technology Organisation and the Australia Safeguards and Non-proliferation Office, the only operational nuclear reactor, the Open Pool Australian Lightwater (OPAL) reactor, uses low enriched uranium in the fields of nuclear medicine and research. Any move towards electricity generation would require amendment of the federal EPBC Act and *Australian Radiation Protection and Nuclear Safety Act 1998*, which currently prohibits the construction or operation of nuclear energy plants in Australia.[77] The states of New South Wales and Victoria also have legislative prohibitions on nuclear power.[78]

The issue of nuclear power generation was last considered, at the federal level, by an expert taskforce in 2006.[79] At that time, the taskforce report noted that nuclear power could be operational within 15 years, and the then government committed to proceeding further towards nuclear power capabilities.[80] Following the 2007 change in government, these plans were halted.

At the state level, the nuclear issue is current and may drive federal consideration of the same. In March 2015, South Australia launched a Royal Commission

[74]Commonwealth of Australia, Department of Industry and Science (2015) at pgs 19–20.

[75]Wood T, Grattan Institute (2014) at pgs 32–33.

[76]Whitmore J and Hopkin M (2015).

[77]*Australian Radiation Protection and Nuclear Safety Act 1998*, s10.

[78]See *Nuclear Activities (Prohibitions) Act 1983* (Victoria), *Uranium Mining and Nuclear Facilities (Prohibition) Act 1986* (NSW) respectively.

[79]Commonwealth of Australia, Department of Prime Minister and Cabinet (2006).

[80]Howard J (2007).

examining the state's future role in the nuclear industry. The Commission is led by Kevin Scarce, who has previously expressed support for a renewed debate on nuclear energy, and its terms of reference include direction to consider "the feasibility of establishing and operating facilities to generate electricity from nuclear fuels in South Australia" as well as "the feasibility of establishing facilities in South Australia for the management, storage and disposal of nuclear and radioactive waste".[81] However, statements made by the state's Premier that suggest the Commission is more likely to recommend the establishment of a waste dump than a power station.[82] Tentative findings are expected to be released in February 2016, with a final report released in May 2016.[83]

In its recently released Energy White Paper, the federal government has indicated that it will be looking to the outcomes of the South Australian Royal Commission in considering any changes to Australia's position on nuclear energy production.[84] In this way, it has avoided indicating support, or otherwise, for any change in its current position but has indicated support for ongoing investment in the nuclear regulatory framework and further development of Australia's nuclear knowledge and skills in order to ensure Australia is capable of moving towards nuclear energy production, if required. While, in and of itself, this isn't a strong indication of a future that includes nuclear energy, it does represent a departure from the statement made in the 2012 Energy White Paper that "the Australian Government does not support the use of nuclear energy in Australia".[85]

6 Renewable Energy Sources

Despite Australia's strong potential in renewable energy technologies, its development in the sector has been slow. In 2012–2013, renewable energy amounted to only 2 % of energy production and 6 % of energy consumption, with high upfront costs and distribution difficulties often cited as reasons for low levels. This disconnect between potential and practice is unlikely to be resolved in the near future. Rather, the government's policy outlook on renewable technologies supports the focus on continued expansion of fossil fuel production featuring lowered targets, private sector funding, and the distinct absence of pricing measures.

[81] South Australian Government (2015).

[82] Australian Associated Press (2015).

[83] South Australian Government (2015).

[84] Commonwealth of Australia, Department of Industry and Science (2015) at pgs 58–59.

[85] Ibid. at pg 45.

6.1 Pricing Measures

Following its election in 2013, the current federal Liberal government repealed two resource-related taxes: the carbon price and the Mineral Resources Rent Tax. In the Energy White Paper, the government makes clear that such pricing measures will not feature as part of its energy policy outlook, referring to these measures including the carbon price, Mineral Resources Rent Tax and feed-in tariffs as "inappropriate taxes and regulation" and claiming that they stifled the innovation and investment necessary for Australia's success.[86]

The carbon price, better known as the carbon tax, was essentially a price paid by polluters per tonne of carbon released into the atmosphere and was intended to incentivise uptake of renewables and reduce emissions.[87] The policy was highly controversial and subject to significant criticism regarding its design and operation. In repealing the measure, the Liberal government claimed that it resulted in increased energy prices whilst making no contribution to reduced emissions.[88] Experts have since stated that increasing energy prices were more likely a response to international prices than a by product of the carbon price and that emissions did in fact decrease in the targeted sectors.[89]

The Mineral Resources Rent Tax, also referred to as the mining tax, was a tax levied on profits over a certain threshold generated from the extraction of coal and iron ore. While not tied directly to renewables but rather based on the notion of "economic rent",[90] it was often linked to discussion of renewable energy in light of calls for the revenue to be directed to investment in renewable energy and other sustainability activities.[91]

6.2 Renewable Technologies

In 2014, renewable energy provided 13.47 % of Australia's electricity, enough to provide power for the equivalent of approximately 4.5 million average homes. Despite this, and Australia's well recognised potential in the area of renewable energy, this sector barely warrants a mention in the government's current energy and resources policy program.

[86]Commonwealth of Australia, Department of Industry and Science (2015) at pg 45.

[87]Clean Energy Bill 2011 (Cth), Explanatory Memorandum.

[88]Hunt G (2014) Second Reading Speech for Clean Energy Legislation (Carbon Tax Repeal) Bill 2014.

[89]O'Gorman M and Jotzo F (2014).

[90]For a discussion see Parliament of Australia (2011).

[91]See, for example, Australian Council of Trade Unions, Australian Council of Social Service, Australian Conservation Foundation and the Consumers' Federation of Australia (Joint Statement) (2010).

The government has introduced legislation, with bipartisan support, to reduce the nation's Renewable Energy Target (RET), which has been operating since 2001, from a 41,000 GWh target by 2020 to 33,000 GWh by 2020.[92] It is widely recognised that, in 2012, Australia had already reached 17,000 GWh of large-scale renewable energy under the RET,[93] nearly half of the revised target.[94] In fact, most experts agree that there are already enough approved projects to meet the target, with the government's own Warburton Review concluding that even the 41,000 GWh target could be achieved.[95] In addition to revising the target, the government abolished the only two other agencies that funded research and development in renewable technologies: the Australian Renewable Energy Agency and the Clean Energy Finance Corporation.[96]

The government's move away from levels of support previously provided to renewable energy development has its roots firmly in concerns about the competitiveness of fossil fuels. The government claims that investment in renewable energy during a period of weak demand contributed to Australia's "major oversupply of electricity generation capacity". In this context, its reduced commitment is focused on sustainable growth.[97] However, the Energy White Paper also details the age and inefficiencies of current fossil fuel production facilities, which will require new investment to ensure Australian energy needs can be met in the future. In this context, the reduced commitment to renewable sources ensures the continued attractiveness of traditional energy sources, thereby securing the necessary investment. The clear priority is in providing continued support and increasing competiveness for fossil fuel energy production.[98]

Federal government policies are not, however, the only source of renewable energy support and development in Australia. Recent state and territory government action is increasingly "green". The South Australian Government has set an investment target of $10 billion in clean energy by 2025 and has already secured $5.5 billion. This target supports already strong performance in the use of renewable energy, with approximately 40 % of South Australia's power in 2014 coming from renewable energy sources.[99] The New South Wales government has declared

[92] *Renewable Energy (Electricity) Amendment Act 2015* (Cth). See also, The Parliament of the Commonwealth of Australia, Parliamentary Library (2015) *Bills Digest no. 119 2014–15*: *Renewable Energy (Electricity) Amendment Bill 2015*.

[93] Commonwealth of Australia (2014) *Renewable Energy Target Expert Panel Call for Submissions*.

[94] Clean Energy Council (2015) at pg 2.

[95] Ibid. at pg 5.

[96] Commonwealth of Australia, Department of Industry and Science (2015) at pgs 57–58.

[97] Ibid.

[98] Ibid.

[99] Clean Energy Council (2014) at pg 4.

its goal to be "Australia's answer to California" for renewable energy, focusing on solar uptake and windfarm development.[100] The Victorian government has also made significant changes to its planning system in order to encourage wind farm development.[101]

6.3 Emissions Reductions

More than renewable technologies, a key feature of the government's current energy and resources policy agenda is greenhouse gas emissions reduction. To this end, the government has established a Direct Action Plan via an Emissions Reduction Fund, which will pay $2.55 billion over 4 years to fund abatement projects in the private sector.[102] The fund will operate as a reverse auction, with businesses competing to undercut each other to win an abatement contract and associated payment. Whereas the carbon price increased energy prices, the fund is intended to support Australian businesses to lower their energy costs and increase their productivity.

The new funding model will move away from ad-hoc funding of projects through multiple platforms towards: direct, targeted investment in emerging energy technologies; improvements in existing technologies and new energy sources; and projects that have a local dimension such as addressing local issues, developing an area where Australia has a natural resources advantage, or capitalising on potential for commercialisation.[103]

However, according to the federal government, the fund is "focuse[d] on practical things that reduce emissions such as indigenous land management, cleaning up power stations, energy efficiency on a grand scale, improving soils by increasing the volume of carbon, [and] looking at vegetation coverage".[104] In this way, the focus of the fund appears to be on supporting fossil fuel production and on ensuring that new technologies support the competitiveness and adaptability of the fossil fuel export sector to future emissions constraints.[105] Although this might not be the "green" focus supporters of renewable energy are looking for, Australia's current use of fossil fuels in generating electricity contributes over one third of its total greenhouse gas emissions,[106] so any decrease in emissions from this sector may be as beneficial environmentally as it is commercially.

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[100]Hannam P (2014).

[101]Clean Energy Council (2014) at pg 17.

[102]Commonwealth of Australia (2014) *Emissions Reduction Fund White Paper*.

[103]Commonwealth of Australia, Department of Industry and Science (2015).

[104]Hunt G (2014) Transcript of interview with Tom Elliott (3AW Melbourne).

[105]Commonwealth of Australia, Department of Industry and Science (2015) at pg 52.

[106]Ibid. at pg 55–56.

Opposition parties strongly opposed the Emissions Reduction Fund, but did not have the numbers to defeat it in Parliament. The deputy opposition leader, Tanya Plibersek, has called it "an absolute dog of a policy", claiming it will involve paying billions of dollars of taxpayers' money to big polluters, with no guarantee of emissions reductions.[107] This sentiment was echoed by Greens leader, Christine Milne, who labelled it an expensive "sham".[108]

7 Conclusion

Despite the relatively open nature of Australia's natural resources sector to trade and investment, the country faces some difficulties in attracting investment and competing at the highest level internationally due to its complex and patchwork nature of resource regulation. For this reason, Australian governments, at both the federal and state and territory levels, are intent on making doing business in the sector even easier, an approach that appears to favour continued exploitation of traditional fossil fuels at the expense of renewable and sustainable opportunities.

Australia is seeking to navigate complicated policy space in balancing its current needs in terms of traditional sources with its future interest in renewable energy. On the one hand, Australia has an oversupply of energy production; on the other, its processes and facilities are outdated and will require substantial investment in order to remain operational and efficient. If renewable energy sources increase their competitiveness and policies are introduced to shift consumption away from fossil fuels and towards renewable sources, investment in those traditional sources will be difficult to attract. Without the capability to sustain Australia's energy needs without any reliance on traditional sources, this is not in Australia's energy interests.

The difficulty lies in striking the right balance between encouraging investment by providing a predictable, regulatory stable and competitive market for traditional sources and sufficiently supporting and encouraging innovation, development and uptake of new energy sources. The government's energy policy program reflects this difficulty, giving rise to a strong sense that, at least in the current outlook, the balance has tipped in favour of trade and traditional sources. This commitment to trade and investment interests is not, however, illustrative of a consensus position across the political spectrum, or even the country. Recent history has illustrated that energy and natural resources policy is susceptible to being "held hostage to bipartisan politics and a revolving-door prime ministership".[109] Whether this uncertainty persists will largely depend on whether the current government is returned at the next election, due by 14 January 2017.

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[107]Plibersek T (2014).

[108]Milne C (2014).

[109]Smith M (2016).

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Chapter 2
Legal System of Natural Resources Protection in China: GATT 20 and China's Export Limits on Resources

Jingdong Liu

Abstract China has recently entered into a new period of development of laws dealing with the use and conservation of natural resources. The Chinese Constitution provides an essential framework for the conservation of natural resources, but protection of ecological values is largely lacking. All natural resources in China are either owned by the state or are collectively owned. China largely lacks a comprehensive legal regime to protect and conserve natural resources. Under Chinese law permission to utilize natural resources depends upon permission from state authorities. The decision of the WTO Appellate Body that interprets China's WTO Accession Protocol to exclude the application of WTO Article XX general exceptions protecting the environment is wrong and unfair.

Keywords Natural resources in China • WTO accession protocol

From 1984, The legal system construction of natural resources has stepped into a fast developing period after the first special natural resources law, "Forest Law of the People's Republic of China", was enacted in 1984. Until now, a legal system framework of natural resources protection which involves a variety of special laws has been initially formed. This system covers the main aspects of Chinese natural resources' development, utilization, protection and management. It also plays a positive role in the development, utilization, protection and management of China's natural resources and makes a great contribution to preventing the natural resources from being destructed, wasted and saving natural resources from depleting. However, now we are faced with a global resources issue and a tougher domestic situation of natural resources. Therefore, it is necessary to comprehensively review the legal status of China's natural resources and improve the legal system, in order to make it serve the Chinese socialist market economy better.

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_2

1 The Legislative Status of China's Natural Resources

Since China adopted the reform and opening-up policy, along with the development of China's democracy and legal system construction, the legislation of natural resources has entered into a new stage of development and the legal system framework of natural resources has been basically formed.

It mainly includes the following aspects:

1. **Territorial Control Law and Territorial Control Plans**. They are the bases of all kinds of resources utilization and protection plans. The ways and principles prescribed by the Territorial Control Law provide a mandatory guidance to activity of utilization and protection of natural resources.
2. **Resources Industry Laws**. The utilization of a kind of natural resource is mainly associated with an economic activity in one industry of the national economy. Now, the Resources Industry Laws of China in force are the Forest Law, Grassland Law, Fisheries Law, Mineral Resources Law, etc.
3. **Special Resources Laws**. This kind of legislation of resources, such as Land Law, Water Law, is mainly for the rational utilization and protection of the resources and is not limited to the management of one industry. Resources Industry Laws and Special Resources Laws are the basic rules for the natural resources allocation regulating the behavior of development, utilization and protection of natural resources. They are the "backbone" in the legal system of natural resources.
4. **Other relevant laws**, such as:

   (A) **The Constitution**. For example, Article 9 of the Constitution said that "The state ensures the rational use of natural resources and protects rare animals and plants. The appropriation or damage of natural resources by any organization or individual by whatever means is prohibited." Article 10 said that "All organizations and individuals who use land must make rational use of the land." Article 26 said that "The state protects and improves the living environment and the ecological environment, and prevents and controls pollution and other public hazards. The state organizes and encourages afforestation and the protection of forests."etc.

   (B) **Administrative regulations**, **policies and technical standards** that prescribe the policies, technical specifications and standards about reasonable utilization and protection of natural resources. These are the social policies and economic policies for the development of resources industry and the development, utilization, protection and construction of resources when they appear in the form of laws. These depend on a certain economic stage or a particular aspect of resources utilization during a period of time, and they are supplementary for the resources industry laws and special resources laws.

   (C) **Relevant legal provisions on Pollution Control Laws and Natural Protection and Construction Laws**. Such as the provisions about reasonable

utilization and protection of natural environment and natural resources prescribed in Environmental Protection Law, Water and Soil Conservation Law, Prevention and Control of Desertification Law, Wild Animals Protection Law and Wild Plants Protection Regulation, etc. For example, in chapter 3 "Protection and Improvement of the Environment" of the Environmental Protection Law, there are many provisions related to natural resources protection and it also makes a principled regulation on natural resources protection. And Article 19 said that" "Measures must be taken to protect the ecological environment while natural resources are being developed or utilized."

(D) **Provisions on protection and reasonable utilization of natural resources prescribed in other legal departments**. Due to natural resources protection involves with extensive factors and comprehensive protective methods, it is prescribed in many laws and regulations. For example, the Criminal Law prescribes" Crime against environmental resources" and the procedural law prescribes the procedural provisions on dealing with all kinds of natural resources disputes.

(E) **Local decrees and local rules** on reasonable utilization and protection of natural environment and natural resources.

5. **The relevant international treaties that China signed or acceded to**. The international agreements that China signed with other countries on the utilization and protection of natural resources and the international conventions that China acceded to on the utilization and protection of natural resources are main components in the Chinese legal system of natural resources.

Until now, China has signed many conventions such as United Nations Framework Convention on Climate Change, Convention on Biological Diversity, United Nations Convention on the Law of the Sea and Convention Concerning the Protection of World Cultural and Natural Heritage. And they all stipulate protection of natural resources.

To sum up, China has formed a basic framework on the legal system of natural resources protection with the constitutional norms as basis, with the environmental protection law as a foundation, with the special laws as a backbone, with other laws and local decrees as a supporting and with the international conventions as a supplement. This framework basically covers the main aspects of development, utilization, protection and management of natural resources in China.

2 Problems in Legislation of China's Natural Environment

The development trends of contemporary natural resources law are: combine the development, utilization of natural resources with the protection and improvement; add more content about the protection, improvement and management of the natural resources on the basis of maintaining the original way of development,

utilization and management natural resources; emphasis on sustainable utilization of natural resources; practice a system for paid use of natural resources; divide the functions and powers of governments at all level reasonably; safeguard the national interests, at the same time, respect personal and legal entity's property rights and offer them the same protection; protect the subject of rights equally.

Although China has established a natural resources legal system, a considerable number of natural resources laws were made before 1992, under the planned economy system. Those laws and regulations with characteristics of planned economy obviously do not meet the requirements of developing market economy. The existing problems are mainly as follows: distribute the resources under the administrative power while ignore the essential role which the market plays in the allocation of resources; ignoring the value and property nature of natural resources, that make it difficult to manifest the real value of the natural resources; carry out different policies based on the ownership and the parties in unequal status; put undue emphasis on the interests and power of the nation and administrative authorities while neglect the interests of citizens, legal persons and other organizations; simply emphasize on the utilization of natural resources and resources projects while neglect the protection of natural resources and ecological environment; responsibilities and authorities between different government departments are not clear, which leads to the low efficiency in enforcing natural resources law.

It specifically manifests in the following aspects:

1. **Ecological conservation is seriously neglected**. Natural resources, as a basic material element for human life and production, take an important role in the economic development and social progress for a nation or a country. In addition, natural resources, as a basic element in the ecological system, play a decisive role in human survival and development during the interaction between human and nature. Therefore, it will be the basic aim and highest value pursuit of a resources law to maintain the sustainable use of natural resources, achieve a coordinated development of population, economy, environment and resources and finally realize harmonious coexistence and common evolution between human and nature. When examine the legislative purpose of current China's natural resources law, we will find that it basically pursues for unsustainable development under the guidance of anthropocentric value. Its direct result is confirming dominative human rights over nature and protecting human's self-mutilation behavior over natural resources such as wanton exploitation, destruction and waste. And it will finally put human being into ecological crisis affecting their survival and development. Apparently this kind of legislative purpose should be reformed.
2. **Law provisions are too abstract to implement**. In China, many laws stay on layer of platform, slogan, policy and declaration and those laws are too abstract to implement. And this kind of situation often happens in natural resources laws. For example, in the agriculture law, many provisions look more like department's policy-related declarations rather than legal provisions. Such as "The State shall gradually increase the overall input to agriculture." "In the

development of agriculture, resources must be utilized in a rational way." In natural resources laws, there are many policy-related declarations:" the State encourages", "the State depends on", "the States supports", according to the specific conditions of the State", "the State shall gradually increase", "the State guides", "the State protects" and so on. Provisions like these are too numerous. In those laws, we can only see national attitude to some things but cannot see practical measures to solve those problems. The negative consequence is that the applicable scope of legal system is unknown and the laws are difficult to implement.

3. **Lack of comprehensive natural resources laws**. China has already established a natural resources legal system which takes a collection of various individual natural resources laws. This kind of law system emphasizes on the development of legal departments and interests of departments and it will result in shortage of cooperation between the special laws and conflicts in department interests. In fact, China's current legislation system is restricted by the administrative system so the resources law is drafted by the relevant resources management administrative departments. Departments responsible for the drafting law will think more of the department's interests and manage, protect and develop resources from their respective perspective rather than consider every possible angle. So the special natural resources laws do not form a harmonious and unified system to protect and develop resources reasonably. Sometime these laws become tools for expanding department's power and protecting department's interests. Therefore, it cannot meet the needs of sustainable development of China, there is a strong need for formulating a comprehensive natural resources management law to protect natural resources and natural ecological environment comprehensively.
4. **There are some loopholes in legislation**. China's current natural resources laws basically cover the whole field of the natural resources but there is still "vacuum zone". The concept of natural resources is developing, and, to human being, the range of natural resources is also changing along with the technological improvement in acquisition and utilization of natural resources and development of social economy. China's recent model is making different laws for different resources. This will inevitably lead to legal blank with the change in scientific definition and range of natural resources. For example, China is in urgent need of formulating Wetland Law, Oil Law and Law of the Sea to solve the lawless problem in the relevant field.
5. **The relevant regulations are not reasonable**. With the population growth, technological development and social-economic progress, China's natural resources legislation lags behind actual needs and does not fit for the operation of market economy. It is mainly reflected in the following:

    1. **Property rights of natural resources are empty**. China's current natural resources property right system cannot act to encourage saving on use of resources and efficient use of resources and even become one cause of destruction in some cases. According to recent China's natural resources

laws, all natural resources are state-owned or collectively owned. However, due to lack of resources property right's representatives and no defined rights and duties of the central government, local governments, departments and local residents in the system, in fact, state and collective ownership are replaced by an informal ownership system. In fact, those informal possession phenomena cause conflicts of interests' distribution in resources utilization and lead to a severe situation that every developer, including departments, local governments and individuals, competes for resources development rights regardless of sustainable utilization of natural resources. This situation makes the reestablishment of natural resources property rights system become a pressing problem in the natural resources legislation.

2. **The transfer system of natural resources is incomplete**. China's natural resources laws neglect prescription on the transfer system of natural resources, mostly because of that the natural resources belong to the state or collective. Only the Land Management Law and the newly-amended Mineral Resources Law prescribe on transfer of land use right and exploration and mining right of mineral resources under special circumstances. However, due to the lack of effective safeguard of corresponding legal provision in land use right transfer, the state land assets are in a serious loss just like in a black hole. According to the estimation of the national bureau of land management, the loss of land assets through the transfer of land use right goes up to 20–30 billion Yuan every year. And the transfer system of exploration and mining right of mineral resources is also at the initial stage and needs specific measures and implement steps to regulate, guide and safeguard.
3. **There are flaws in pay acquisition system**, **price system and accounting system of natural resources**. The compensation system of resources renewal is blank or incomplete and a lot of resources are still in worthless and free mining stage. At the same time, because of the effect of traditional concept, the resources price system does not get high attention and the value of resources does not truly comprehensively reflected. "Worthless resources, cheap raw materials, but expensive products", this price phenomenon is quite prominent. Furthermore, the resources accounting system has not been established. In pursuit of economic growth, people change resources reserve into consumption goods at a faster speed for the growth of output value. However, there is no item to compensate resources loss in the GNP accounting. This aggravates the situation that resources are inefficiently and wastefully used.

6. **The provisions of laws are in conflict** It is mainly indicated on two aspects: on the one hand, there are contradictions and conflicts between different special natural resources laws. China does not have a unified comprehensive natural resources law to constrain and coordinate. And the administrative system that natural resources are managed by each department leads to legislative system that natural resources law is drafted by each department. With lawmakers' attention to their departments' interests, the "laws and regulations fight"

phenomenon in special natural resources laws is inevitable. The recent only way to solve problems is the administrative way. Different natural resources have different attributes and characteristics and they are all an integral part of the natural ecosystem, so they are always in a coevolution process with mutual cooperation, mutual dependence. This requires that the natural resources laws have to confirm and maintain this kind of relationship. Objects of China's natural resources laws are crossed, force of those laws are in disordered levels, problems of departments' interests are serious and the comprehensive department does not play its role well so the resources laws has become legal tools and methods to claim departments' power, maintain departments' interests and offer departments' protection which leads to a serious situation where departments' interests expand and the whole function is difficult to play.

On the other hand, there are contradictions and conflicts between China's environmental law and resources laws. Article 6 of the Environmental Law said that the State Environmental Administration and the Local Environmental Administrations are the authorities for environmental protection and govern natural resources protection and the prevention and control of pollution work. However, natural resources laws and regulations only prescribe duties and power for the natural resources authorities but do not mention duties for environmental protection authorities. This legislative tendency obviously excludes environmental authorities from natural resources protection and management departments and runs counter to the Environmental Law which results in the uncleanness between the power and responsibilities.

3 The Improvement and Perfection in Legislation of Natural Resources of China

On the surface, the protection and exploitation of natural resources is only how to use natural resources, however, it is essentially the pursuit of the harmony between human and nature, as well as the fairness and justice on the issue regarding natural resources between people.

Adjust the interpersonal relationship through the adjustment of the human-nature relationship, and then promote the orderly development, these are most important. With the clear definition of rights and obligations in the law, disputes can be avoided, solved and we can coordinate the interests of all parties and contradiction better. Using the legal method to solve the problems on natural resources, is the essential requirement of the society of rule of law.

1. The content regarding sustainable development needs to be added in the Constitution.《Care for the Earth – A Strategy for Sustainable Living》jointly compiled by IUCN(World Conservation Union), UNEP(United Nations Environment Program) and WWF(World Wide Fund For Nature) clearly put

forward, countries should adopt a global declaration and covenant concerning sustainable development, make commitment on the sustainable living code of ethics, and the principle of sustainable living should be embodied in the constitution and domestic legislation. Therefore, the Chinese legislation on natural resources should be amended and improved on the basis of the above spirit. The terms on sustainable development have not been included in the current Constitution of China, so the amendment and addition about this issue is needed.

2. The enactment of unified 《Natural Resources Protection Law》. Many countries have enacted, or are enacting natural resources law. So far, the conditions for enactment of 《Natural Resources Protection Law》 have gradually become ripe in China. First of all, the thought of sustainable development involves many aspects such as resource, environment, technology, investment and market etc. But from the overall and long-term perspective, only the resources and environment is the main factor to determine its constancy, and the resource utilization is central issue. The purpose of enactment of natural resources protection law is to realize sustainable development. Rational utilization and exploitation of natural resources, to meet the needs of social economic, culture and material life, and can meet the rational needs of the next generation. Furthermore, the reasonable exploitation, utilization and protection have been given an important position. All of this has provide good policy environment and policy support for enactment of 《Natural Resources Protection Law》. In addition, the enactment of 《Natural Resources Protection Law》is the need to construct and perfect the legal system of natural resources of China. The legal system of natural resources should be an holistic system with the clear level of effectiveness, and it also should be based on classification of natural resources, was led by 《Natural Resources Protection Law》, with a variety of administration regulations and local regulations as main part and relevant laws as supplement. The enactment of 《Natural Resources Protection Law》 is an important measure to make up the deficiency of the recent system and structure. In short, the enactment of 《Natural Resources Protection Law》 not only has practical condition, but also is imperative.

4 The Basic Characteristics of the Legal System Regarding the Protection of Natural Resources

4.1 The Legal System for the Paid Use of Natural Resources

The system of paid use for natural resources refers to a set of administration measures that the state has individual and unit pay the costs for exploitation and utilization of natural resources by coercive measure. It is an administration system set up and developed in the situation of population expansion and natural resources shortage, and is the embodiment and confirmation of natural resources value in the law. For a long time, people always think natural resources is valueless, and then

occupy, exploit and use natural resources without payment, and even the natural resources without human labor is regarded as no value in some of authoritative theory, resulting in over exploitation and waste of natural resources. With the increase of the population, the shortage of natural resources become more and more serious. Even resources crisis appeared in the 1960s and 1970s. At present, in many areas of world, the shortage of fresh water, forest resources has become indisputable fact. The shortage of wildlife resources will cause endangerment and extinction of wild animals and plants. This will arouse us to rethink the theory of "invaluable resources", put forward and establish the natural resources values and value theory.

Now, the concept of the value of natural resources has been accepted by most of economists, and it reflected in the economic policy and legislation in many countries. The legal system that can reflect the value of natural resources is the system of paid use of natural resources. The establishment of this system has important significance and functions in many aspects. Firstly, it is helpful to promote the rational exploitation and utilization of natural resources. Secondly, it is helpful to raise funds for the exploitation of new resources, and is conducive to the protection and restoration of natural resources. Thirdly, it is conducive to the protection of natural resources sustainable utilization, and promote economic and social sustainable development.

The form of paid use of natural resources varies depending on specific situation of different countries and areas. In general, two main forms, taxation and payment, are common. The countries with more developed market economy usually take the form of taxation, and developing countries and the countries with economic transformation are usually take the form of payment. Most of countries take both of the two kinds of form.

4.2 The Filing System of Natural Resources

The filing system of natural resources refers to a series of works that include collecting, sorting and archiving the data and results of natural resources, and collective keeping. The purpose of establishment of natural resources filing system includes three main aspects. The first is to learn the present situation and changes; The second is to evaluate the effect of exploitation and utilization, protection and management; The third is to provide reliable basis for making natural resources plan, determining the goals of exploitation and utilization, and measures of protection and management.

4.3 The Natural Resources Permission System

Natural resources permission system, also known as natural resources license system, it refers to a set of administration measures of application, approval and license before the activities of exploitation and utilization. It is the legislation of natural resources permission, is also an important measure for administrative authority to protect and supervise the natural resources.

The natural resources permission system could strengthen the unified administration on activities of exploitation and utilization, and control them within the range of national regulations. It is beneficial to the pre-review and control, and disapprove the activities which is harmful to natural resources sustainable development. It is also beneficial for authorities to implement effective supervision and administration to the license holders, according to the changes and needs of objective situation.

The natural resources license can be divided into three categories from its nature. The first one is nature resources license, such as, the tree cutting license, mining license, fishing license, gathering license etc.; The second one is resources utilization license, such as land using license, grasslands using license, aquaculture license; The third one is imports and exports license for resources, such as wildlife import and export license.

5 GATT Art. 20 and China's Export Limits on Resources

According to the current positioning of accession protocols by the WTO, accession protocols are "agreed terms with the WTO" and "an integral part" of the WTO agreement. The former explains only the content of an accession protocol, while the latter only concerns the legal effects of an accession protocol in the WTO legal system(as "an integral part" of the WTO Agreement, accession protocols are binding for both the new and the original members of the WTO). The question then arises, in the WTO legal system, especially in terms of its relations with the WTO covered agreements, how about the precise legal relationship between an accession protocol and WTO Agreements? Or is it an agreement independent of the other new covered agreements? Is it an amendment to the WTO Agreement, or just a special provision of the universal rules of WTO covered agreements which an accession protocol applies to new member according to their specific situation? Only if we get clear answers to these questions, can we completely solve the issue of the status of accession protocols in the WTO legal system.

From the existing rulings made by the DSB, we can see DSB's basic view toward the above issue. Up to now, the DSB has made rulings in two cases related to Chinese Accession Protocol. One is the "*China – Publications and Audiovisual Products case*", and the other is the controversial "*China – Raw materials case*."

In the case of "*China – Publications and Audiovisual Products*," China invoked Article XX of the GATT 1994 to justify a violation of Paragraph 5.1 of its Accession Protocol dealing with trading rights. Since the case was related to the sensitive issue of the relationship between the protocol and the WTO covered agreements, at the beginning, the Appellate Body obviously tried to avoid tackling this problem. But in order to make a ruling, it had to choose the means of treaty interpretation to address the issue. "*In its assessment, the Appellate Body did not discuss the systemic relationship between provisions of China's Accession Protocol and those of the GATT 1994, within the WTO Agreement. The Appellate Body instead focused on the text of the relevant provisions of the Protocol, including an examination of the meaning of the particular terms at issue, as well as the surrounding context and overall structure of the Accession Protocol*".[1]

In this case, China held that it followed the provisions in the introductory clause of Paragraph 5.1 of China's Accession Protocol – "*without prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement*" as well as the provisions of Paragraph 6.1. Obviously, ""*WTO Agreement*" *refers to all agreements that are incorporated into the WTO Agreement and are an* "*integral part*" *of it. Such an interpretation ensures a balance between China's rights deriving from its accession to the WTO, and other WTO Members' rights deriving from China's accession commitments*." Thus, China was of the view that Article XX of the GATT could be invoked to solve disputes concerning provisions in the Accession Protocol. However, the United States, which issued the complaint, and some third parties objected to China's position. The United States argued that the relationship between Article XX(a) of the GATT 1994 and the Accession Protocol was a question of broad systemic import, .and although the Accession Protocol was an integral part of the WTO Agreement, Article XX of the GATT1994 was not incorporated into the Accession Protocol. According to the US, the language of Article XX makes it clear that it may only be invoked with respect to measures that violate another GATT provision. Consequently, China had no right to invoke article XX of the GATT to solve disputes concerning provisions in Accession Protocol. Ultimately, the Appellate Body supported China's view by means of interpreting treaties. The reasoning was that the words in Paragraph 5 and 6 indicate that Article XX of the GATT had already been incorporated into the Accession Protocol, making itself a part of China's Accession Protocol. Thus, China had the right to invoke Article XX of the GATT as an exemption.[2]

Because the Appellate Body finally supported China's rights as a new member, the way the Appellate Body sought to solve the dispute concerning the Protocol by avoiding the relationship between the protocol and covered agreements, and by interpreting provisions of the Protocol, did not trigger much legal debate. However, this approach posed a considerable legal risk later when the DSB addressed the "China – Raw Materials Case" dispute.

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[1]Reports of the Panel, China-Raw Materials, para. 7.117.

[2]Reports of the Panel, China-AV, paras 4.434–35, 7.739, 5.9–5.10, 5.27.

In the succeeding "China – Raw Materials" case, the Panel followed the way of treaty interpretation taken by the Appellate Body to resolve the relationship problem between the Protocol and the covered agreements, and made a ruling which put China as a new WTO member at a disadvantage. This ruling aroused significant controversy within China.

The panel in that case stated that, in contrast with Article 5.1 in the "*China – Publications and Audiovisual Products*" case, Paragraph 11.3 in the Accession Protocol lacked the clear specification of invoking Article XX of the GATT or other provisions of the GATT. Nor did it include an introductory clause similar to Paragraph 5.1 of the Accession Protocol. Therefore, Article XX of the GATT had not been incorporated into Paragraph 11.3. Thus, China had no right to invoke Article XX of the GATT as an exemption.[3]

In the panel's view, "*the deliberate choice of language providing for exceptions in Paragraph 11.3*, *together with the omission of general references to the WTO Agreement or to the GATT 1994*, *suggest to us that the WTO Members and China did not intend to incorporate into Paragraph11.3 the defenses set out in Article XX of the GATT 1994*."[4] The panel further pointed out that "*To allow such exceptions to justify a violation when no exception was apparently envisaged or provided for*, *would change the content and alter the careful balance achieved in the negotiation of China*'*s Accession Protocol*. *It would thus undermine the predictability and legal security of the international trading system*."[5]

The panel applied the legal phrase "careful balance" in reference to the provisions in the Accession Protocol, which the Appellate Body did not disapprove. . From the use of this legal term, the basic view and stance of the DSB toward the Protocol's legal status can be inferred.

From the perspective of jurisprudence, the word "balance" conveys that provisions of accession protocols constitute the balance of rights and duties between new members and other members. Therefore, the phrase "careful balance" means, in the panel's and the Appellate Body's view, that the provisions of an accession protocol are the result of negotiation between old and new members. It is a relationship of rights and duties between new and old members, which has nothing to do with the existing covered agreements.[6] The nature of this perception is to regard an accession protocol as a new agreement, which is completely independent from and equal to the covered agreements. This undoubtedly means that when there is a dispute between new and old members, it is these "new agreements" that shall be applied. Furthermore, covered agreements can only be invoked by a new member when the provisions in the Accession Protocol explicitly mention the

[3]Panel Reports, *China-Measures related to the exportation of various raw materials*, WT/DS394/R/WT/DS395/R/WT/DS398, (Panel Reports), para. 7.XII4, para. 7. XII6–7.XII9.

[4]Panel report, *China- Raw materials*, para. 7. 129.

[5]Panel report, *China- Raw materials*, para. 7.159.

[6]Matthew Kennedy,'The Integration of Accession Protocols into the WTO Agreement.' *Journal of World Trade* 47, no. 1 (2013):p. 45.

WTO covered agreements. In short, according to this view and logic, as for the relationship between new and old WTO members, the terms of the Protocol shall prevail, while the universal rules in WTO covered agreements become exceptions.

Soon after the ruling was released, it not only aroused China's strong opposition against the Appellate Body's positioning of accession protocols outside the WTO covered agreements, but the ruling was also seriously criticized by scholars of international law.

European scholars such as Elisa Baroncini pointed out that the Appellate Body's explanation in the "China – Raw Materials" Case has brought about a series of serious consequences. First, she believes that in accordance with the Appellate Body's logic, the elimination of export taxes is a "WTO-Plus" obligation, which can not be exempted by the GATT's public policy exception, allowing members to take domestic measures violating WTO's pillar principles of Most-Favored-Nation treatment (MFN) and National Treatment to protect their non-trade interests. This is obviously unreasonable. Secondly, this approach will place a heavier burden on China. Meanwhile, it will also lead to serious institutional problems in the WTO's jurisdiction. Furthermore, since many of the "WTO- Plus" obligations in the Protocols will be difficult to correct in the future, the Appellate Body's accession approach undoubtedly makes the asymmetry of "WTO- Plus" obligations even worse.[7]

Another scholar, Matthew Kennedy, who was formerly a senior lawyer in the WTO Secretariat, holds that the panel's and the Appellate Body's view of the Protocol of Accession as only a part of the WTO Agreement is clearly wrong. The WTO Agreement as well as the annexes including the WTO covered agreements and the DSU are part of a greater whole. As part of the WTO Agreement, Accession Protocols are undoubtedly a part of WTO Agreements covering all the annexes. In other words, they belong to an instrument. Otherwise, it would be very difficult to explain why a new member does not need to join the WTO covered agreements individually, and these covered agreements can still enter into force on this new member from its accession. In this view, an accession protocol is not a separate legal instrument, but a reflection of the WTO's concrete and special requirement for each new member. Regardless of whether the protocol has invoked provisions of GATT1994, GATT1994 provisions are applicable to all new members.[8] As for some paragraphs of the Protocol which do not mention GATT, it is because these terms are new WTO obligations which are not included in the existing covered agreements. Even so, these terms should be understood along with WTO agreements, rather than being viewed as new and independent WTO agreement.[9]

[7]Elisa Baroncini, 'The *China-Rare Earths* WTO Dispute: A Precious Chance to Revise the *China-Raw Materials* Conclusions on the Applicability of GATT provision XX to China's WTO Accession Protocol.' Cuadernos de Derecho Transnacional (Octubre 2012), Vol. 4, N° 2, pp. 58–59.

[8]Matthew Kennedy, 'The Integration of Accession Protocols into the WTO Agreement.' *Journal of World Trade*, *Vol*. 47, No. 1 (2013): pp. 64–66.

[9]Ibid. p. 75.

In the "China- Raw Materials" case, the practice of regarding an accession protocol as a new WTO covered agreement by the panel and the Appellate Body according to their "new balance" theory, not only failed to accord with WTO jurisprudence, but it was also unfair to new members. Moreover, whether the Appellate Body has the right to decide the legal status of accession protocols in the WTO legal system is a question in itself, because the authorization of the DSB in the "Scope and application" of Paragraph 1 in the DSU does not clearly imply that an accession protocol is covered.[10] Rather, Article 9.2 of the WTO Agreement states that "*The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements*." Since an accession protocols is an integral part of the WTO Agreement, according to Article 9.2 of the WTO Agreement, the authority of interpreting it does not belong to the DSB, but to the Ministerial Conference and the General Council.

The DSB's interpretation of accession protocols not only lacks a legal basis, but also has been suspected of being ultra vires. Nevertheless, accession protocols are of vital importance to the new members' basic rights and obligations. For such an important issue, it is obviously inappropriate for the DSB to deal with it just through legal interpretation. In fact, the DSB's ruling in the "China – Raw Materials" has already seriously harmed China's interests that China should gain under the WTO agreement as a new member, which is extremely unfair for China.

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[10]Mitali Tyagi, "*Flesh on a legal fiction*: *Early practice in the WTO accession protocol*," Journal of International Economic Law 15(2), p. 398. Professor Charnovitz also once pointed out"Before one jumps to the conclusion that any such agreement (with the WTO) is necessarily enforceable in the DSU, one should consider the implications of saying that the WTO Ministerial Council has authority to enter into an agreement with any other subject of international law (e.g., the United Nations) and then by joint consent use the DSB to resolve disputes. In my view, it will be important for the WTO judicature to justify enforceability in a way that does not have negative unintended consequences for the WTO." Steve Charnovitz, '*MAPPING THE LAW OF WTOACCESSION*', p. 79, *The George Washington University Law School*, *Public Law And Legal Theory Working Paper No. 237*, *Legal Studies Research Paper No. 237*.

Chapter 3
Law and Policy on Mineral Resources in Mongolia: Seeking Inescapable Stability

Amarsanaa Batbold

Abstract This chapter addresses the issue of the development of mineral law and policy of Mongolia. Within this framework uniqueness of Mongolia and its legal system discussed, further looking at the historical aspect of law and policy of natural resources. Then current major state policy documents of Mongolia and export control approach is mentioned while touching major mining projects in modern Mongolia and its public perception. Also the chapter addresses current issues of mineral policy and law and concludes. This chapter does not address petroleum and nuclear energy related aspect of laws in Mongolia.

Keywords Mongolia • Minerals • Mining • Law and policy • Public perception • Current issues

1 Introduction to Mongolia and Its Legal System

Mongolia is a country different from other major mineral exporting countries of the world. By its location, Mongolia is closest mineral exporting country to China while being also close to mineral rich Russia, with low number of population in its large territory which enables the growth of mining industry possible. On the other hand, mode of life in countryside of Mongolia is unique and animal husbandry based on nomadic lifestyle is critical to people in Mongolia.

This chapter addresses the issue of the development of mineral law and policy of Mongolia. Within this framework uniqueness of Mongolia and its legal system discussed, further looking at the historical aspect of law and policy of natural resources. Then current major state policy documents of Mongolia and export

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An early version of this paper was contributed by Dr. Idesh and the content of this publication does not reflect the official opinion of any government body. Responsibility for the information and views expressed here lies entirely with the author.

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_3

control approach is mentioned while touching major mining projects in modern Mongolia and its public perception. Also the chapter addresses current issues of mineral policy and law and concludes. This chapter does not address petroleum and nuclear energy related aspect of laws in Mongolia.

1.1 Overview of Mongolia

Mongolia is a mineral-rich country landlocked between Russia and China. It is only a few countries in the world which do not have sea transportation which is critical to trade for some natural resources such as coal. Due to its uniqueness of location, only meaningful mode of freight transportation for natural resources is railway and railroad that is connected to Trans-Siberian railroad network passes through the country from Russia to China. Mongolia is the closest country to China, the major importer of natural resources, and Russia, a country with huge untapped deposit of natural resources especially in the region close to Mongolia and China.

It is a country with a population of only 3 million (about 823,000 households) and with over 55 million heads of livestock[1] mainly sheep, cattle, camel, horse and goat. Less than a half of the population[2] lives in countryside living in nomadic lifestyle and herding livestock. Due to its small population and large territory, Mongolia has one of the lowest population of densities of any country in the world.

Almost three times the size of France, it is ranked 19th largest country in the world after Iran. The geography of Mongolia is varied, with the Gobi Desert to the south, mountainous regions to the north and west, and steppes, with forested areas in central and eastern part. It has number of lakes, rivers and other water resources though it is considered as not sufficient. Due to its low number of population, nomadic lifestyle and low level of industrialization, its natural composition is untouched and it has potential for ecotourism.

The Mongolian economy is becoming dependent on the mining and agricultural sectors which have a direct impact, both on economic policy and on the conditions for foreign direct investment. For example, in 2015 the mining sector accounted for over 87.8 % of export, 13.0 % of GDP.[3] These factors make Mongolia vulnerable to external shocks due to decline in certain commodity prices.

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[1] МОНГОЛ УЛСЫН НИЙГЭМ, ЭДИЙН ЗАСГИЙН БАЙДАЛ, МУ-ын Улсын бүртгэл, статистикийн ерөнхий газар [Social and Economic State of Mongolia] (2015) p. 13. Available at http://ubseg.gov.mn/content/1236#.VxTKZkdm5GI

[2] Монгол Улсын нийгэм, эдийн засгийн байдал, МУ-ын Улсын бүртгэл, статистикийн ерөнхий газар [Social and Economic State of Mongolia] (2015) p. 14. There are about 217 thousand households herding livestock. Available at http://ubseg.gov.mn/content/1236#.VxTKZkdm5GI

[3] Монгол Улсын нийгэм, эдийн засгийн байдал, МУ-ын Улсын бүртгэл, статистикийн ерөнхий газар [Social and Economic State of Mongolia] (2015) p. 11. Available at http://ubseg.gov.mn/content/1236#.VxTKZkdm5GI

Mongolia is a multi-party, parliamentary democratic republic which the Parliament, the State Great Hural, is authorized to discuss any issues pertaining to domestic and foreign policies including passage of laws.[4] Due to its parliamentary democracy with strong Presidential power and active participation with high number literate population,[5] policies and laws are disputed and discussed frequently and mining related policy issues have been center to this public and political discussions since 2000s. In its economic and other relations, Mongolia pursues peaceful, multi-pillar, open foreign policy maintaining neutrality and it has established diplomatic relations with over 186 countries.[6]

1.2 *Overview of Legal System*[7]

Mongolian legal system follows continental legal tradition with strong influence of German and Russian codification culture.[8] Since allowing private property in early 1990s, Mongolian legal system is reforming its laws and institutions significantly adopting legal mechanisms based on free market principle. Even today, it is widely considered that there is a potential and need to reform its legal system in order to increase its efficiency and to balance social, economic, and other impacts.

There are number of legal instruments issued both in central and local government levels ranging from statutes, decrees of the Parliament, Cabinet, Presidential decrees, Ministerial ordinances, local government and local assembly decrees and these are binding to all the persons and their activities when applicable. Mining and natural resource related matters are regulated and influenced by different level of legal instruments adopted by both central and local governments in Mongolia. Strong culture to rely on statutory documents is inherited even before transition to market-based economy and there were number of statutes which were effective during the socialist, non-private property regime.[9]

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[4]Constitution of Mongolia (1992) art. 25.1.1 and 25.1.2.

[5]According to Mongolia's Population Census of 2011, 98.3 % of population is literate. See MONGOLIAN STATISTICAL YEARBOOK 2011, p. 31. Available at www.nso.mn and www.1212.mn (Unified Statistical Data System of Mongolia).

[6]For list of countries see http://www.mfa.gov.mn/ last visited on March 30, 2016.

[7]For general discussion of Mongolian legal system in English see S. NARANGEREL, LEGAL SYSTEM OF MONGOLIA, 2004.

[8]For detailed discussion see "ЭРХ ЗҮЙН ШИНЭТГЭЛ БА ҮНДЭСНИЙ ЭРХ ЗҮЙН ТОГТОЛЦОО" ОЛОН УЛСЫН СИМПОЗИУМЫН ЭМХТГЭЛ (Legal Reform and National Legal System" International Symposium Proceedings), Hanns Zeidel Foundation, 2000; Batbold Amarsanaa, ХАРЬЦУУЛСАН ЭРХ ЗҮЙ СУДЛАЛ [Comparative legal studies], 2nd ed., 2014.

[9]For the sample list of legal instruments around 1974 see БҮГД НАЙРАМДАХ МОНГОЛ АРД УЛСЫН ҮНДСЭН ХУУЛЬ ТҮҮНД ХОЛБОГДОХ АКТЫН ЭМХТГЭЛ [Compilation of acts related to the Constitution of Peoples's Republic of Mongolia], (1974).

2 Legal and Policy Framework on Natural Resources: History

Mining in Mongolia is not a new sector in the modern history of the country. During the twentieth century, Mongolia has opened several mines and operated them successfully either independently or jointly with several foreign governments. Thus the legal system has history dealing with mining industry and there is some level of public understanding and perception on mining, its character especially in the regions that large mining projects operated in the past.[10]

Minerals sector in Mongolia has seen several statutory documents, and statutes which replaced each other in the past. The oldest document at the beginning of 20th century that solely dealt with mining and mineral resources was Mining Regulations of Bogd Khan's Mongolia of 1913. Subsequently, Mining Regulations of People's Government of Mongolia of 1923, Law of Mongolia on Subsoil of 1988 was adopted during the socialist regime. Later the separate statutes were adopted by the Parliament, which are Minerals Law of Mongolia of 1994, Minerals Law of Mongolia of 1997 and Minerals Law of Mongolia of 2006.

Mining Regulations of Bogd Khan's Mongolia regulated those issues that are deemed important such as applying and granting exploration and mining rights, prohibition to transfer and sale of its rights, amount of royalty for different minerals, customs duty, freedom to choose labor force.[11] Later Mining Regulations of People's Government of Mongolia of 1923 was adopted and its immediate purpose was to nationalize all the mines and invalidate concession rights and re-issue right to explore and mine to individuals and societies.[12] This Regulation became more comprehensive compared to previous Regulation and it included rules related to applying and granting exploration and mining rights, allowing transfer and sale of exploration and mining rights, amount of royalty, occupational safety, trade union, possibility of concluding agreement with investors who invested[13] large amount.

Law on Subsoil which is effective today governs subsoil in Mongolian territory thus have direct effect on mining operations. The Law regulates use and protection of subsoil, powers of the central and local government organs, geological and mining activities, fee for maintaining subsoil rights and duties of subsoil users, registration of deposit reserves, dispute resolution.

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[10] Бүгд Найрамдах Монгол Ард Улсын Үндсэн хууль түүнд холбогдох актын эмхтгэл [Compilation of acts related to the Constitution of Peoples's Republic of Mongolia], (1974).

[11] For details see MINERALS LAWS OF MONGOLIA (1910–2010), compilation by B. Ulziibayar and B. Tsetsenbileg, 2010, pp. 6–10.

[12] Art. 1 and 2 Mining Regulations of People's Government of Mongolia (1923), in MINERALS LAWS OF MONGOLIA (1910–2010), compilation by B. Ulziibayar and B. Tsetsenbileg, 2010, p. 12.

[13] Minerals Laws of Mongolia (1910–2010), compilation by B. Ulziibayar and B. Tsetsenbileg, 2010, p. 19.

Then Law on Minerals of 1994 was adopted after the acknowledgment of private property in Mongolia. It defined powers of the Parliament, Cabinet, Ministries as well as local governments. This Law was a major departure from government owned and controlled mining industry to mining industry with domestic and foreign private investments. However, it had provisions indicated heavy government involvement such as the state priority right to purchase minerals with world market price.[14] The adoption of new Minerals Law and other commercial laws[15] resulted in considerable positive effect on mining business in Mongolia.

At the time of the adoption of the Law on Minerals of 1994 Mongolia's economic performance not only improved but also led the Government of Mongolia to take a series of economic measures initiating financial sector reform, eliminating tariffs, introducing value added tax and launching a large scale privatization program. The Parliament of Mongolia thus passed the new Law on Minerals in 1997 with a view of mainly facilitating foreign direct investment. This Law on Minerals of 1997 was very liberal in a sense that issuance of license was based on first come first served basis.[16] Thanks to this statute, licensed areas in Mongolia increased dramatically later calling for action from the government.[17]

These actions resulted in considerable progress in the effectiveness of the activities of mining companies and inflows of foreign direct investment have been increased in 2000s. The strong presence of foreign direct investment in the mining sector had proven effectiveness of the mineral law reform during this period. In particular, separate laws dealing with various issues of mining activities including legislation on licensing of economic activities, taxation and environmental impact assessment have been enacted or amended.

For the above reasons, the legal regime for mining activities has been developing at rapid pace since the adoption of the Constitution of Mongolia in 1992.

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[14]Art. 5.4 Law on Minerals (1994) in Minerals Laws of Mongolia (1910–2010), compilation by B. Ulziibayar and B. Tsetsenbileg, 2010, p. 41.

[15]For example, the Foreign Investment Law was adopted in 1993. For an overview of the development of the Mongolian foreign investment law see I.Idesh ''Impact of International Law on the Development of the Mongolian Investment Legislation and Its Legal Consequences" (2012), INTERNATIONAL WORKSHOP PROCEEDINGS TRENDS OF THE DEVELOPMENT OF INTERNATIONAL LAW IN MONGOLIA, School of Foreign Service of the National University of Mongolia, National Intelligence Academy, National Legal Institute of Mongolia, Ulaanbaatar.

[16]ЭРДЭС БАЯЛГИЙН ЭРХ ЗҮЙН ТОЙМ (Introduction to Mineral Resources Law) (2012), National Legal Institute of Mongolia, Anand Batzaya advocates, Ulaanbaatar, pp. 14–19.

[17]Kohn, Michael. "*Mongolia Ends Moratorium on Issuing Mineral Exploration Licenses*" Bloomberg, 2 July 2014. Web. 18 Apr. 2016.

3 Current Policy Framework of Natural Resources

As mentioned above, statutes and other secondary laws govern mining activities. Moreover, there is policy document which is "social contract" amongst members of society, government and business. Although policy documents, and government programs do not have immediate legal effect on society, it is generally reflected in the legislation and for instance, Ministry of Mining claims that since 2014 it formulated its policies and draft laws in compliance with policy documents discussed here.

3.1 An Attempt Towards Stability: State Policy on Mineral Resources

Legislation in minerals sector, especially previous Laws on Minerals, was central to public discussion and political agenda. Thus legal framework was subject to frequent amendments and these were large in scale in the past. It was once considered most frequently amended statutes[18] due to strong lobby from the different interest groups and radically changing concepts. Mongolia's national policies on foreign investment and mineral resources and mineral legislation have been sharply affected by a number of domestic and international developments since 2009. The adoption by the Parliament of Mongolia of the Law on Regulation of Foreign Investments in the Economic Sectors of Strategic Importance[19] and other laws[20] was met with strong opposition from foreign and domestic investors in Mongolia. For all these reasons, the State Policy in Mineral Resources is adopted in July, 2014.

The new State Policy on Mineral Resources defines mining sector specific objectives and priorities and its key goal is to accelerate development of mining industry and increase private sector participation in the Mongolian economy. In this context, the Government identifies private investment as a vital source of much needed capital, technology, management know-how and access to international markets. Foreign investment and direct participation in a wide range of mining related industries are actively encouraged. Such involvement is particularly encouraged in connection with the exploration, extraction and processing of mineral resources.

This policy document adopted by the Parliament which was intended to be implemented between 2014 and 2025 stipulates that draft laws to be submitted in

[18]For instance, Law on Minerals of 2006 which is effective currently are amended every year between 2008 and 2016.

[19]This Law restricted foreign direct investment in certain sectors of the Mongolian economy and then was replaced by the Investment Law of Mongolia in 2013.

[20]The laws which have prohibited to grant exploration licences were adopted in 2011, 2012 and 2013.

compliance with the principles and purposes of the Policy. Further, state budget, state monetary policy, mid-term and long-term planning and annual Social and Economic Guidelines of Mongolia should reflect the policy.[21] Moreover, this policy was intended to be implemented in consistence with policies of other sectors. It is structured into four sections, namely General provisions, Principles in minerals sector, Policy guidelines for the minerals sector, Implementation methods, stages and expected results of the Minerals Policy. And improving legal environment and to develop corresponding rules, regulations, program and project was scheduled to be held in year 2014 and 2015.

This policy focuses on national interests to develop conspicuous and responsible mining relied upon private sector and aims to develop multisectored and balanced economy. By its objective, it has declared to establish stable investment environment, to improve quality of mineral exploration, mining and processing by encouraging use of environmentally friendly and advanced techniques, technologies and innovations, to produce value-added products and strengthening competitiveness of the country in the international market.

Principles to be followed in the minerals sector in Mongolia is aimed to provide adequate social and economic benefits to the public from minerals sector. Principles that were named in the document are the following[22]:

– not to breach legal interests of any stakeholder and to base decisions reflecting research and investigation outcomes and to ensure long-term sustainability for the minerals policy;
– encourage and introduce environmentally friendly advanced modern technology, techniques and innovations for exploitation and processing industry;
– ensure transparency and accountability in government organizations and companies;
– obey Mongolian laws, conduct its business mutually beneficial way, and support good corporate governance by investors;
– ensure equal treatment and nondiscrimination to investors;
– transparency of geological, mining and processing information, funded by state and private sectors except those restricted by laws;
– improve occupational safety and hygienic laws and regulations to satisfy international standards and to implement them accordingly;
– maintain proper level of state involvement in mineral exploration and mining activities while improving the state administration at registration, approval and supervision.

Policy guidelines for the Minerals Sector is composed of seven sections. In order to improve legal environment of the sector, it plans to develop legal environment for artisanal mining; to improve laws related to transferring title of mineral

[21]Resolution 18 of the State Great Hural, 16 January, 2014. For english translation See http://en.mongolianminingjournal.com/content/54797.shtml

[22]Art. 2.1 State Policy on Mineral Resources (2014–2025).

exploration and mining licenses; to adopt international standards that evaluates mineral deposit reserve; to develop dispute resolution system in mining sector. In the geological sector, geological explorations and prospecting activities are aimed to intensify and to increase registered mineral deposit of Mongolia. In the mining operations, it is aimed to introduce advanced technology in order to increase productivity in mining industry and maximizing its competitiveness. Processing of minerals are core in this document, and it states to establish legislative environment of processing industry and to maximize processing level of minerals. From the environmental perspective, maintaining environmentally friendly technologies at mining and processing stages; using surface and processed water, re-cycling and re-processing of mining waste are considered as main topics.

To establish dialogue mechanism comprised of interest groups such as investors, government officials, professional association and civil society, wealth funds for distribution of wealth in the society, consistency of central and local government policy and decisions, to train qualified engineers and technical personnel, to convert state-owned entities into publicly owned companies are mentioned.

Thus State Minerals Policy intends to fill the gaps of most critical aspects of mining industry in Mongolia and touches such topics that are discussed mostly before the adoption of this document.

3.2 Other State Policies on Mineral Resources

Besides the State Policy on Mineral Resources, there are several policy documents related to mineral resources adopted in the Parliament or Cabinet level. For instance, the National Security Concept of Mongolia which was renewed in 2010 by the Parliament has defined a policy toward balancing investment in the mining sector and avoiding status of raw materials exporting country. Moreover, it has stipulated that Mongolia should strive for global and regional integration in its foreign trade and consider the possibilities of concluding free trade agreements.[23] Like provisions are also stipulated in the Foreign Policy Concept of Mongolia which was adopted in 2011 by the Parliament.[24]

There is also a policy document adopted by the Cabinet "Economic Foreign Relations Program".[25] This document provides that the program shall support activities of Mongolia stipulated in the policy documents, including the State Policy on Mineral Resources, by diplomatic means and mechanisms. To achieve it, according to article 2.2 of the Program, it will aim to increase access to foreign markets, support export oriented activities of business organizations, to increase competitiveness of business organizations and to attract foreign investment.

[23]The National Security Concept of Mongolia, Resolution 48 of the State Great Hural, (2010).

[24]The Foreign Policy Concept of Mongolia, Resolution 10 of the State Great Hural, (2010).

[25]The Economic Foreign Relations Program of Mongolia, Cabinet Decree 474, (2015).

3.3 Export Related Aspects of Mineral Resources

As mentioned previously in this chapter, Mongolia is dependent on export of mineral resources. As a member of World Trade Organization, Mongolia pursues free trade and has minimal intervention in export of mineral resources. There are statutes that regulates export although Mongolia does not have specific statutes that focus on export of mineral resources. Moreover, it is important to note that Mongolia recently concluded its first Economic Partnership Agreement (EPA) and this Agreement also regulates export restrictions between Mongolia and Japan.[26]

Mongolia has policy to export minerals resources by market principles and sell minerals by fair market price. Mining license holder entitles to sell mineral products at international market price.[27] Moreover, the State Policy on Mineral Resources stipulated to establish commodities exchange in Mongolia in order to have integrated export regulation on mineral resources.[28]

The recent decisions of the Government of Mongolia shows attempts to re-organize mining companies that fully or partially controlled by the government under the umbrella of government holding company. This government holding company is established looking at the examples of foreign experiences such as Singapore's Temasek, and Kazakhstan's Samruk-Kazyna. Once it is re-organized into holding company structure, it may have some influence on export of mineral resources through company internal policies. However, for some large mining companies in Mongolia, export regulations stabilized at the time of signing of an agreement with the Government of Mongolia.[29]

2014 Amendment to the Law on Minerals of 2006 has introduced a new concept of export control over minerals extracted from the mining. Under this concept, a mining license holder has to pay the state budget royalties based on values of all products extracted from mining claim or sold or shipped for sale or mined. This new control is facing strong opposition from foreign and domestic investors in Mongolia since it increased transaction and production cost of license holders.

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[26] "Agreement Between Japan and Mongolia for an Economic Partnership," March 10, 2015, accessed April 18, 2016, http://www.mofa.go.jp/a_o/c_m2/mn/page3e_000298.html

[27] Art. 27.1.4 Law on Minerals (2006) as amended in 2015.

[28] Art. 3.7.3 and 4.3.10, The State Policy on Mineral Resources (2014).

[29] See Provision 1.4 of Oyu Tolgoi Investment Agreement between Government of Mongolia and Ivanhoe Mines Mongolia Inc LLC and Ivanhoe Mines Ltd and Rio Tinto International Holdings Limited dated October 6, 2009. Available at http://www.turquoisehill.com/i/pdf/Oyu_Tolgoi_IA_ENG.PDF. There is also policy study conducted at the Open Society Forum "Уул уурхайн салбарын бодлогын зарим асуудлууд Оюу Толгойн жишээн дээр гаргасан санал, зөвлөмж" [Some Issues of Mining Sector Policy: Opinion and Suggestion based on Oyu Tolgoi Example], Open Society Forum, 2009.

At present legislative working group of the Ministry of Industry has prepared a new draft Law on Trade which provides that non tariff measures can be enforced for foreign trade in order to protect non-renewable natural resources[30] and a mining companies may ship its export products only after the relevant advance payment has been transferred into its bank account in Mongolia and the permit to ship the minerals to foreign markets has been given to such mining company by the customs office in question.

To be brief, there is no or little export restrictions for mineral resources at present although there are internal discussions, as mentioned above, and some arrangements that may have indirect influences on how to handle export of mineral resource products in the future.

4 Codification Attempt: Current Legal Framework for Minerals in Mongolia[31]

The current Law on Minerals ('the 2006 Law on Minerals') was adopted and replaced Law on Minerals of 1997.[32] This statute introduced a concept of investment agreement which became invalid in 2013 and regulated various issues of the development of exploration and mining projects and environmental aspects of mining activities. The Law sets forth the general principles of the legal regime applicable to mining activities and mining companies.[33] Other than Law on Minerals, there are other statutes that relate to mining such as Law on Land on legal aspects of land use, Law on Environmental Impact Assessment on environmental protection etc. However, these issues are not considered in detail within the framework of this chapter. Following the adoption of the 2006 Law on Minerals, the Government of Mongolia has approved operation of several large mines.

This statute has stipulated rules related to state regulation in minerals sector, prospecting and exploration, mining of minerals, conditions for maintaining eligibility to hold a license, obligations of a license holder, transfer and mortgage of

[30]Худалдааны тухай хуулийн төсөл (draft Law on Trade), March 2, 2015 version available at http://mi.gov.mn/images/turiin_uilchilgee/huuli/Hudaldaanii_tuhai_huuliin_tusul.pdf

[31]Minerals Laws of Mongolia (1910–2010), compiled B. Ulziibayar and B. Tsetsenbileg, 2010.

[32]For reference about related Mongolian laws see I. Trifunov and Y. Krouchkin, MONGOLIA: ITS MINERAL RESOURCES & LAW ENCYCLOPEDIA, Moscow, 2000; J.R. Wingard and P. Odgerel, COMPENDIUM OF ENVIRONMENTAL LAW AND PRACTICE, 2001; Pekka Hallberg, RULE OF LAW ADMINISTRATIVE JUSTICE MINING, MONGOLIA-FINLAND, 2013.

[33]At present, Mongolia has adopted separate law on petroleum and radioactive substances which more typically regulate relations in the petroleum and nuclear power sectors and not mining. The Petroleum Law was adopted in 1991 and issues of importation, production, sales and transportation of petroleum producs are regulated by the 1995 Petroleum Products Law. The Law on Nuclear Energy was adopted in 2009.

licenses, termination of licenses, information, royalty revenue distribution, reimbursement and specifics of finance and accounting, dispute resolution arising in connection with licenses and penalties in case of breach of the Law.

Legal aspects of ownership of natural resources are stipulated by the Constitution of Mongolia,[34] Law on Land, Law on Minerals and other laws and all minerals resources occurring on and under the earth's surface in Mongolia are the property of the State. Foreign nationals including foreign investors and companies with foreign investment are not permitted to own land. Foreign invested mining companies in Mongolia are limited to acquiring land use rights. However, they may own property constructed on the land such as building, factories, warehouses and other structures.[35] The current Law on Minerals does not restrict foreign investment in exploration and mining license holders.

However, this Law imposes requirements for state equity participation in mining project and the State may own up to 50 % of participating interests in a private legal person if declared as a deposit of strategic importance according to art. 5.4 of the Law on Minerals. The State may also own up to 34 % of the shares of an investment to be made by a license holder in a mineral deposit of strategic importance when its proven reserves have not been determined by the means of state budget funded explorations. Later these requirements of the Law was eased allowing the government to replace its equity participation with special royalty.[36]

Exploration and mining license holders must be Mongolian legal entities and only an exploration license holder is entitled to apply for a mining license in the exploration licensed area pursuant to Article 24.1 of the Law. Exploration license holder has priority right to apply for and obtain mining licenses provided that such legal persons satisfy the requirements set forth in the Law on Minerals. Mining licenses are issued for a period of 30 years with right to extend the term of the mining license two times for a period of 20 years.

The Law on Minerals provides for the transfer of exploration and mining licenses with certain restrictions. An exploration license holder may transfer its license to another legal person eligible to hold the license only after providing proof that the materials and reports on prospecting and exploration work have been sold/transferred and taxes have been paid. Pledging of licenses is also allowed and issues of pledge agreement are regulated by the Law on Minerals. Exploration and mining license holders may pledge their licenses to banks or non-banking financial organisations with a view of financing their investments and mining projects.

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[34]The Constitution of Mongolia provides expressly that land, underground resources, air and water are object of exclusive ownership by the people of Mongolia. See Article 6.1 of the Constitution of Mongolia. The Land Law provides for ownership of land by Mongolian citizens and the State. See in detail the Law on Land of Mongolia www.legalinfo.mn

[35]See art. 12.1.1, Law on Investment of Mongolia (2013).

[36]Arts. 5.3–5.5, Law on Minerals (2006) as amended in 2015.

At some point in the past, Law on Minerals tried to regulate wide range of areas and even included provisions to stabilize taxes for minerals sector.[37] The current Law on Minerals[38] is a key source of mineral legislation and contains detailed provisions on all phases of mining activities and rights and obligations of license holders and other stakeholders.

5 Mining Projects and Public Perception

In the beginning of twentieth century, multinational mining joint stock society "Mongolor" which traded its stocks in Saint Petersburg, Emperial Russia was operating 15 gold mines in Mongolia between 1900 and 1918.[39] The founding investors of this gold mining society, which registered in Russia, was emperial family members of Russia, Belgium, companies and individuals of the United States of America, Germany, Qin Dynasty etc.[40] This society extracted, by some calculations, 10 tonnes of gold per year during its peak operation and was third largest gold mining company in Emperial Russia.[41] Later this society was winded up by the Soviet Russia in 1918. To operate gold mine in Mongolian territory, the society received concession rights from the Government.

Later several large mining projects such as coal mines controlled by the Mongolian Government, large copper, uranium, fluorspar mining joint ventures with Soviet Union were carried out. Copper mine project in central Mongolia has been one of the biggest copper ore mining and processor since 1978 and sells its products worldwide. Also Mongolia is fourth largest fluorspar producer in the world and sells its product regionally. Up to 1990 Mongolia was integrated into "Council for Mutual Economic Assistance" (COMECON) markets and trade, including minerals trade, was carried out mostly within COMECON countries. The assistance of the COMECON member-countries had played a vital role in the development of the Mongolian economy. As a World Bank study put it: '[T]he Soviet Union, . . . was also principle purchaser of Mongolia's exports of copper concentrate, wool, leather goods, and meat. Between them the [COMECON] countries absorbed 97 % of

[37] Art. 20.2 and 20.4, Law on Minerals (1997). According to this Law which is ineffective to date stabilized tax regime for 10–15 years.

[38] There are number of secondary legislation such as mining regulations and procedures which have been adopted by the Ministry of Mining, Ministry of Energy and Mineral Resources Authority of Mongolia. These rules and procedures regulate such issues of mining activities as the safety, open pit operations, issue of mining licenses, submission of information and reports to the Mineral Authority and other government agencies and other issues of mining operations.

[39] REPORT ON THE "MONGOLOR" GOLD CONCESSIONS IN THE TUSHETU KHAN AND TSETSEN KHAN AIMAKS, OUTER MONGOLIA, Peking-Mongolor Mining Company, 1921.

[40] D. Bat-Ulzii, Mongolor was a Multinational Joint Stock Society, CONFERENCE PROCEEDINGS "PENDING ISSUES OF INTERNATIONAL LAW AND MINING SECTOR", 2013, p. 91.

[41] D. Bat-Ulzii, pp. 92–94.

Mongolia's exports and much of this period, the main transport link with the outside world ran through Western Siberia into the Soviet Union."[42] Since nearly all production and distribution activities were concentrated in large scale state-controlled monopolies, legal rules that regulated and limited mining sector and its trade were minimal and its activities were negotiated at the government level. Moreover, mining projects that were initiated together with COMECON countries at that time had political aspect such as building exemplary town or city giving lower priority to its business aspect.

Until the mid of 1990s, public perception of mining was neutral and/or passive for the reason that the state had tightly controlled public opinion, new mining projects were rarely commenced and those mining projects in operation were controlled jointly or solely by the Mongolian Government. During the first half of 1990s, the Government initiated and implemented a policy so called "Gold program" that encouraged private gold mining in order to overcome Mongolia's economic difficulties and increase national gold reserve. Although it increased gold mining production substantially, environmental damage and lack of reclamation of mined areas became source of criticism towards mining sector in general. This program became one of the first signs that private companies, both domestic and foreign, can operate mines, dramatically changing previously understood notion of public that only government controls and operates mining projects.

Later in 2000s, due to the increase of commodities prices, discovery of new minerals and world class mining deposits of copper, gold and high grade metallurgical coal close to Chinese border, Mongolian public became more active, sometimes showing signs of resource nationalism[43] and this increased government involvement in the topic significantly. Since then such topics as resource nationalism, so called concept "permanent sovereignty over its natural resources",[44] stability in the legal and regulatory environment, equal and fair share from natural resources to the country and investors, equal distribution of wealth, inclusion of community interest, environmental protection became center of discussion within central and local government levels and with mining companies, investors, and society in general. All these public perception influenced and reflected in some degree to the policy-making and legal environment in the natural resources sector today.

[42]DEVELOPING MONGOLIA, World bank, Washington, D.C., 1991, p. 1.

[43]Kohn, Michael. *Mongolia coalition takes shape*, *fans fears of resource nationalism*. Reuters, 20 July 2012. Web. 18 Apr. 2016.

[44]For overview *see* General Assembly resolution 1803 (XVII), *Permanent Sovereignty over Natural Resources*, (14 December 1962) available at http://legal.un.org/avl/ha/ga_1803/ga_1803.html

6 Current Issues of Policy and Law in Mineral Resources Sector

As development of Mongolian mining sector has been dynamic since 1991, different problems are surfacing. One of the most discussed topics in the country is how to establish an industry that will value add on minerals products. In that spirit, most of the policy documents such as National Security Concept, Foreign Policy Concept, Economic Foreign Relations Program and State Policy on Mineral Resources were drafted. For that purpose, coordination of mining law and policy to industralization policy are critical.

On the other hand, there is also another coordination problem confronting Mongolia. It was mentioned recently that "[p]olicies governing extractives are unstable and have been hampered by a lack of policy coordination between government ministries and agencies, and poor engagement with stakeholders including the public."[45] There is a lack of coordination for instance between Ministry of Mining and Ministry in charge of Environment, or central government or local government when it comes on mining and environment or showing inconsistencies of decisions.

Although the importance of the mining sector is growing for the economic development of Mongolia, it should be noted that the on-going businesses and mining operations do cause environmental problems such as causing a considerable damage to the health and livelihood of local people and herders who lose their pastureland and water resources.[46] As of 2011, 17,000 ha have been exploited for mining activities in 15 provinces of Mongolia and only 5000 ha of land have been reclaimed.[47] Besides that more than 1000 ha of soil have been damaged because of the so called artisanal mining operations.[48] For these reasons, various civil society organisations have emerged at the end of 2000 and they are now involved in various legislative drafting activities.[49]

[45] Country strategy note Mongolia, Natural Resource Governance Institute, May 2015, available at http://www.resourcegovernance.org/sites/default/files/nrgi_Mongolia-Strategy_20151207.pdf

[46] Environmental aspects of mineral legislation are not considered in detail.

[47] M. Enkh-Amgalan, The Resource Sector in Mongolia: Is It Time for Mongolia to Consider Embracing FSIs? Is Production Sharing Agreement a better Option for Mongolia?, *Mongolian Law Review Journal* (2013–2014), No. 3, International Law Committee of the Mongolian Bar Association, Ulaanbaatar, p. 60.

[48] In Mongolia issues of artisanal mining operations are regulated by the governmental act and this issue attracts the interests of lawyers and legal scholars. For this issue see P. Munkhselenge, Legal issues in the Mining Sector of Mongolia, *Mongolian Law Review Journal*, (2013–2014), No. 3, International Law Committee of the Mongolian Bar Association, Ulaanbaatar.

[49] For instance civil society groups were very active in the last two revisions of the Minerals Law of 1997. See in detail N. Algaa, Building a stable legal environment of mineral resources is the basis of economic development, Paper presented to the International Workshop on Legal Regulation of Market Economic Relations: Conflict of Interests and its Consequences, Shihihutag Law School, Ulaanbaatar, 2014, pp. 134–138.

As we have described in the previous part of this chapter, Mongolia has adopted a comprehensive Law on Minerals setting out the legal regime for mining activities. Law on Minerals of 2006 with its amendments up until 2016 provides a liberal regime and legal guarantees for mining projects. For instance, transfer and pledge of licenses, indiscrimination of domestic and foreign investors, license holders right to export minerals to foreign markets extracted from the mining claim can be mentioned. However, minerals legislation of Mongolia is still developing under the much restraint and strong but opposing positions from various interest groups such as political parties and movements are regularly expressed. For example, at the Parliament level, there are still entirely opposed approaches to solving problems of regulation and government involvement of mining concessions and projects. The Law on Minerals of 2006 were amended or modified every year between 2008 and 2016 and the provisions which mainly regulate license fees and royalties seriously affect the economic and financial activities of mining companies. At the same time the Government of Mongolia intends to make amendments and modifications to the existing Law on Minerals and other laws. Besides that the State Policy in the Minerals Sector 2014 provides that the government shall improve the legislation dealing with the issues of transfer of exploration and mining licenses, transfer of shares of mining license holders and gold export control.[50]

7 Conclusion

Magnitude of change in minerals sector and its legal environment is great since 1991 compared to minerals sector during socialist time and even prior. Due to its unique location, rich mineral deposits near to Chinese market, it has a huge potential. However, minerally rich regions of Russia is also very close to China which may increase competition in similar commodities.

Since the time Mongolia liberalized legal regime of mineral laws, Mongolia became strong competitor in Chinese market and sudden increase of mining projects throughout Mongolia made mining industry dynamic sometimes difficult to control and coordinate. At the same time increasing national wealth, there were not a few mining projects that damaged environment badly and that gave negative impression in terms of distribution of wealth within society, fair share of revenue between private investor and government, Mongolian people in general.

As we have seen from previous discussion, importance of legal system to mining sector was low until 1990s which is not necessarily bad. However, as a result of acknowledging private property and business, the importance of legal systems and

[50]Issues the human rights, environmental protection and public participation are considered in the State Policy on Mineral resources. For detailed discussions of these issues see I. Idesh, Local Development Issues of Minerals Law: International and National Law perspective, CONFERENCE PROCEEDINGS “PENDING ISSUES OF INTERNATIONAL LAW AND MINING SECTOR”, 2013.

rules are constantly increasing and their effects are predictable. Indeed, Mongolia have seen negative consequences of Law on Regulation of Foreign Investments in the Economic Sectors of Strategic Importance and inconsistencies of rules and policies.

Although 25 years since 1990s is not a long time for the mining industry itself, it had up and downs that caused frequent policy and legal change. Given that Mongolia is most likely to rely on mining industry and minerals sector in short and mid-term,[51] it needs more stable legal and policy environment that is based on the recently adopted and well-received State Policy on Mineral Resources. On the other hand, Mongolia certainly needs to amend the existing Law on Minerals and other laws regulating environmental and other issues of Law on Minerals with the framework of the State Policy on Mineral Resources in the near future.

Biggest challenge for the mineral sector shall be underdeveloped export of minerals. As discussed, Mongolia is a member of WTO, has concluded first EPA with Japan. Other than that Mongolia was very liberal in terms of export of its mineral resources. However, recent change of legal environment and discussion in the government shows that sign of change in the export control of the minerals in Mongolia. Most likely this is going to be most significant issue in the come few years. Learning from the previous experiences and instability of law and policy of mineral resource, Mongolia needs to maintain stable environment for its trade of minerals while constantly improving legal mechanisms based on the spirit of the State Policy on Mineral Resources. Export of minerals while considering constantly export control is inescapable to facilitate the growth of Mongolian economy and well-being of its people.

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Chapter 4
Natural Resources Regime in India: Impact on Trade and Investment

R.V. Anuradha and Piyush Joshi

Abstract The process of economic liberalization commenced in India in the 1990s, and has resulted in regulatory reform to allow for increased private sector participation in sectors such as national highways, airports, ports, electricity generation and distribution, etc. However, there has been no significant legislative reform in laws relating to the natural resources sector, where the prevailing legal framework in sectors such as coal, petroleum, and natural gas, dates back to the 1950s and vests the central and state governments with comprehensive jurisdiction and control over natural resources. A key reason for lack of legislative reform in this sector is the sensitivities involved at the local and state levels, and absence of a single party government that can initiate and sustain legal reforms. To keep pace with a liberalized investment regime, the executive wing of the government has been initiating actions to encourage private sector participation. This has in turn triggered increased scrutiny of government action by the judiciary. The Supreme Court of India has recognized that the natural resources of India are impressed with a public trust that limits in certain ways the ways the government may exploit and allocate these resources. The public trust doctrine as interpreted by the Supreme Court prevents the government from conferring a benefit on private persons without adequate consideration of the public interest, including the protection of environmental quality. India maintains and levies export taxes on several types of natural resources.

Keywords Natural resources in India • Export taxes • Public trust

1 Introduction

Natural resources is an issue that is strategically important for all countries. Most countries worldwide typically use trade restrictions as well as pricing regulations in order to regulate production, consumption and trade of such resources. Like most

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© Springer Japan 2016

M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_4

countries, natural resources is a highly regulated sector in India. This paper will focus on regulation of mineral resources, coal, petroleum, oil and natural gas. There are laws governing each of these sectors. Additionally, the judiciary in India has played an active role, not just through interpretation of the statutory provisions, but also through evolution of legal principles that have had a significant impact on the nature of governmental control over allocation and distribution of such resources.

The process of liberalization that commenced in the 1990s, has seen enhanced dismantling of government controls and increasing private sector participation in the past decade. The liberalization process in sectors such as national highways, airports, ports, electricity generation and distribution, initiated since the mid-1990s, have mostly accompanied by significant changes in the underlying legislative framework, which therefore provided greater legitimacy for the liberalization initiatives.

It is interesting to note, however, that in the case of natural resources, there has not been any significant changes in the overall legislative framework. Rather, private sector participation has been primarily initiated through executive decision-making. While the existing legislative framework for natural resources continues to provide for extensive government controls, and state-controlled entities play a significant role in the sector, the limited policy space for executive decision making has been exercised in a manner that has allowed for increased participation from the private sector, especially in the mining of minerals.

One possible reason for lack of legislative changes in the framework for natural resources is because natural resources is a highly sensitive area, in respect of which any overhaul of the legislative framework has practically not been possible due to the coalition nature of India's political governance set-up since the late 1990s. This has made politically sensitive sectors such as mining and natural resource development, difficult to legislate upon, while it is relatively easier to govern these sectors through executive action. This exercise of executive powers however, has not been without controversy, and this has resulted in increased judicial scrutiny and intervention, which has in turn led to development of a growing body of jurisprudence in the area of natural resources management, the role of the state and the extent to which private players can exploit natural resources in India.

An important development in this regard is the evolution of the *public trust* doctrine through judicial pronouncements that have clarified that the state holds the natural resources of the country in *public trust* for the benefit of its people. Consequently, there can be no private ownership of natural resources, and any involvement by the private sector is limited to exploration, prospecting and exploitation of these resources for specified time periods, as authorized agents of the state and are also subject to clear legal "public interest" obligations. The public trust doctrine, therefore, has significant implications for any investments into natural resources in India, and potentially for trade in natural resources.

Part I of this paper will provide a brief overview on sector specific governing regulatory framework. Part II will discuss the evolution of the *public trust* doctrine with regard to natural resources in India. Part II will discuss the prevailing trade restrictions.

2 Regulatory Framework Governing Natural Resources in India

2.1 Overview of India's Domestic Regulatory Framework

India has a federal governance structure, with both the Union and State Governments having the power to make laws with regard to various aspects specified under the Constitution of India. With regard to most natural resources, the legislative power is vested with the Union Government. These include:

- Atomic energy and mineral resources necessary for its production.[1]
- Regulation and development of oilfields and mineral oil resources; petroleum and petroleum products; other liquids and substances declared by Parliament by law to be dangerously inflammable[2];
- Regulation of mines and mineral development to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.[3]
- Fisheries beyond the territorial waters and extending up to the exclusive economic zone;
- Regulation and development of inter-state rivers.[4]

State Governments have jurisdiction over:

- Mines and minerals not regulated by the Union Government;
- Fish and fisheries resources within the territorial area[5];
- Agriculture[6];
- Water resources, including issues relating to supply and irrigation.[7]

Electricity, is a subject under the Concurrent List, over which both Union and State Governments have jurisdiction.[8] Protection of forests[9] and wildlife[10] is also an area over which both Union and State Government have jurisdiction.

The Constitution of India also recognizes the inherent power and duty of the government with regard to protection of the environment. Environmental law in

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[1]Entry 6, List I of Schedule VII, Constitution of India.
[2]Entry 53, List I of Schedule VII, Constitution of India.
[3]Entry 54, List I of Schedule VII, Constitution of India.
[4]Entry 56, List I of Schedule VII, Constitution of India.
[5]Entry 21, List II of Schedule VII, Constitution of India.
[6]Entry 17, List II of Schedule VII, Constitution of India.
[7]Entry 14, List II of Schedule VII, Constitution of India.
[8]Entry 38, List III of Schedule VII, Constitution of India.
[9]Entry 17A, List III of Schedule VII, Constitution of India.
[10]Entry 17B, List III of Schedule VII, Constitution of India.

India also finds its roots in India's participation in international environmental agreements- which is an area within the jurisdiction of the Union Government.[11]

Thus, the Constitution of India has carved out petroleum and development of oilfields and mineral oils to be vested under the complete exclusive control of the Union Parliament, and in relation to other minerals and natural resources, has vested Union Parliament with the authority to enact a law that can enable it to identify, from time to time, minerals that fall under the control of Union regulation. Water, due to its inherent linkage with agriculture has been retained as a subject to State level regulation, but inter-state rivers fall under the jurisdiction of Union Parliament.

The sections below will discuss the regulatory framework applicable in key natural resource sectors. Overall, the discussion will explain how India's regulatory framework has a strong focus on regulatory controls; pricing controls and allows the government to impose export taxes when required. Some of these aspects are raised by India's trading partners for incorporation in being addressed in India's free trade agreements. For instance, commitments on export taxes have been sought by both the European Union and the European Free Trade Area, during trade negotiations. India has however so far not undertaken any commitments on this aspect.

2.2 Regulation of Mines and Minerals

As noted above, regulation of mines and mineral development (other than petroleum, mineral oils, oilfield development, which vests exclusively with the Union) is divided between the Union and State Governments, with Union Government having the power to regulate mines and minerals to the extent to which such regulation is declared by Parliament by law to be expedient in the public interest.

The Mines and Minerals Development and Regulation Act, 1957 (MMDRA), and Mineral Concession Rules (MCR), 1960 framed under the MMRDA, provides the governing framework for the manner in which the Union Government regulates mines and minerals in India.

Under the provisions of the MMDRA and MCR, prior approval of the Union Government is required for grant of mineral concessions in respect of minerals specified in the First Schedule to MMDRA. The First Schedule to MMRDA is divided into three parts Part A "Hydrocarbons/Energy Minerals" which comprises

[11]Entry 14, List I of Schedule VII, read with Article 253, Constitution of India.

of only Coal and Lignite; Part B "Atomic Minerals" which lists 11 minerals[12] and Part C "Metallic and Non-Metallic Minerals" which lists 10 minerals.[13]

The MMRDA stipulates that no person can undertake activities relating to: (i) reconnaissance, (ii) prospecting; or (iii) mining operation in any area except in accordance with the relevant license granted for the activity. Specific licenses or permits are granted to the prospector at each stage of mining which are subject to payment of royalties and fees which are intended to be used for the conservation and systematic development of mineral endowments. The MMRDA had earlier not provided for a comprehensive prospecting and mining license, but had only (under section 11) provided a preferential right in grant of mining lease to the entity that had been issued the prospecting license. There was therefore a risk associated with undertaking prospecting expenses since there was no assurance that mining rights would be granted to the same entity that had prospected and discovered the viable deposits. Legislative amendments in 2015 introduced the concept of the "prospecting license-cum-mining lease", which provides for a two-stage concession for the purpose of undertaking prospecting operations followed by mining operations.[14]

The framework governing mining leases has sought to be made more certain with the MMDRA (Amendment) Act, 2015 with the period for mining lease for minerals in Part A of First Schedule being clearly stated to be not less than 20 years and not exceeding 30 years with a possibility for renewal for an additional period of 20 years. In relation to minerals *other than those mentioned in Part A and Part B of the First Schedule* (i.e., minerals other than coal and Atomic minerals), mining leases shall be granted for fifty (50) years and all mining leases granted before the promulgation of the MMDRA (Amendment) Act are now deemed to have been granted for fifty (50) years.[15]

The imposition of a minimum period in the coal mining leases and minerals other than atomic minerals has been brought in to remove the executive arbitrariness that had crept in vesting of coal leases where short term leases were being issued resulting in wastage and inefficiency in mining.

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[12]Atomic Minerals listed in Part B are: (1) Beryl and other beryllium bearing minerals, (2) Lithium-bearing minerals, (3) Minerals of the "rare earth" group containing uranium and thorium, (4) Niobium bearing minerals, (5) Phosphorites and other phosphatic ores containing uranium, (6) Pitchblende and other uranium ores, (7) Titanium bearing minerals and ores (ilmenite, rutile and leucoxene), (8) Tantallium bearing minerals, (9) Uraniferous allanite, monazite and other thorium minerals, (10) Uranium bearing tailings left over from ores after extraction of copper and gold, (11) Zirconium bearing minerals and ores including zircon.

[13]Metallic and Non-Metallic Minerals in Part C are: (1) Asbestos, (2) Bauxite, (3) Chrome-ore, (4) Copper ore, (5) Gold, (6) Iron ore, (7) Lead, (8) Manganese ores, (9) Precious stones and (10) Zinc.

[14]New s.3(ga) incorporated into the MMDRA vide s.2 (ii) of the MMDRA (Amendment) Act, 2015.

[15]s. 8A MMDRA.

The concept of a "District Mineral Foundation" that would work for the interest and benefit of persons and areas affected by mining related operations has been introduced by the MMRDA (Amendment) Act.[16] The State Government is mandated to establish a trust, as a non-profit body, in districts that are affected by mining related operations, which shall be called as the relevant district's Mineral Foundation. The holder of mining leases or prospecting license-cum-mining lease in a district for which the District Mineral Foundation has been established shall, in addition to the royalty, pay an amount as prescribed by the Central Government, which amount shall not exceeding one-third of royalty amount being paid under the relevant mining lease.[17]

2.2.1 FDI in Mining Sector

Foreign direct investment (FDI) without any restrictions on equity caps, under the automatic route,[18] is allowed in respect of:

- Exploration activities of oil and natural gas fields,
- Infrastructure related to marketing of petroleum products and natural gas,
- Marketing of natural gas and petroleum products,
- Construction of petroleum product pipelines, natural gas pipelines, LNG regasification infrastructure.

Petroleum refining in the private sector. However, in respect of petroleum refining by public sector undertakings (PSUs),[19] without any dilution of domestic equity or disinvestment by government, FDI limited to 49 % under automatic route. FDI into the mining for metal and non-metal ores (including diamonds, gold, silver and precious ores), has been liberalised to enable 100 % FDI under the automatic route.

FDI in mining for substances that have been notified as "prescribed substances"[20] under the Atomic Energy Act, 1962 is completely prohibited.

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[16]New s. 9B MMDRA, introduced by s. 9 MMDRA (Amendment) Act, 2015.

[17]New s. 9B MMDRA introduced by s. 9 MMDRA (Amendment) Act, 2015.

[18]'Automatic route' in respect of FDI means that no prior government approval is required for making an investment. This is in contrast to the 'approval route' which is subject to prior government approval. There are two broad ways in which FDI can occur in India: (i) under the automatic route whereby there are no limits on the nature of investment in the sector concerned; and (ii) approval route, whereby FDI will be subject to government approval in the concerned sector. As will be discussed below, despite a fairly liberal FDI regime, actual investments are limited because of the stringent regulatory framework.

[19]"Public Sector Undertakings" are industrial undertakings owned by either the Union Government or State Government.

[20]These are essentially nuclear materials, fissionable materials and non-nuclear materials used for reactors, nuclear related dual use materials. Titanium and Zirconium were earlier notified as "prescribed materials" but vide an amendment in 2006, they were removed from the list of "prescribed materials" and opened for FDI.

For Titanium bearing minerals and ores, FDI is allowed up to 100 % under the ‘approval route’, i.e., it is subject to obtaining prior Government approval for such investment.

2.3 Coal and Coal Mining

The Coal sector was nationalized and all aspects of coal including mining, storage, distribution, and allocation were gradually taken over by the Union Government over a period between 1947 (year of India’s independence) till 1973 (when all coal mines were finally nationalized by Coal Mines (Taking Over of Management) Act, 1973 which nationalised 711 coal mines). A consolidated statute for coal mines nationalization was also passed in 1973, namely the Coal Mines (Nationalization) Act, 1973. The coal mines were placed under the overall jurisdiction of Coal India Limited, a public sector undertaking completely controlled by the Government of India. The only exception to the nationalisation of coal mining activity was private companies engaged in the production of iron and steel.

Since 1993 the Government of India established, through executive notification, a process of “coal block allocation” for captive use by power plants, iron and steel plants and cement plants. Under the “coal block allocation” scheme a “Screening Committee” was established (under an Office Memorandum of 1993, that was reconstituted through a similar Office Memorandum in the years 2000, 2003 and 2005) that identified eligible entities to be awarded coal blocks that were pre-identified by Coal India Limited for being available for allocation to eligible private sector activities. The Screening Committee determined the suitability of the coal block for development by a private sector entity based on its requirement and end use plan. The letter of allocation was the first step after which the relevant allotee had to apply to the State Government for grant of prospecting license/ mining license under the MMDRA and other related clearances such as environment clearance, forest clearance (if the allocated block falls in a declared forest area) etc. The mining lease is granted by the State Government to an entity allocated a coal block only after verification that all statutory requirements have been fulfilled.

This approach basically resulted in allocation of 214 coal blocks that concentrated the ownership of coal reserves among a few business groups, and skewed the industry dynamics in their favour. The top 10 allottees are estimated to have bagged 22 % of the coal reserves.

This entire allocation process was challenged under a series of writ petitions that were consolidated under the case and judgment delivered by the Supreme Court in the case of *Manohar Lal Sharma v. The Principal Secretary & Ors*.[21] The Supreme Court of India held that the practice and procedure for allocation of coal blocks by

[21]Writ Petition (Crl.) No. 120/2012 dated August 25, 2014.

the Union Government through administrative route is inconsistent with the law, and that the "allocation of a coal block" amounts to a "grant of largesse". The allocation letter confers a valuable right in favour of the allottee, as the right to obtain prospecting license or mining lease of the coal mine is dependent upon the allocation letter.

The Supreme Court concluded that the coal block allocation had been done casually, and without application of mind. It therefore struck down the allocation of 204 coal blocks on the reasoning that the Screening Committee responsible for approving the allocations had not acted on material or relevant factors and there was no fair and transparent procedure, and that this resulted in unfair distribution of natural wealth.

In aftermath of what was appropriately called 'coalgate', the legislature enacted the Coal Mines (Special Provisions) Ordinance, 2014 that laid out a road map for ensuring coal supplies in the wake of the Supreme Court's order cancelling captive coal-block allocations. The purpose of the Ordinance is to smoothen the process for sale of coal in the open market. It creates three categories of mines:

(i) Schedule I mines which includes all the coal mines cancelled by the Supreme Court, any land acquired by the prior allottee in or around the coal mines, and mine infrastructure. These can be allocated by way of either public auction or government allotment. Schedule II and III mines will be allocated by way of public auction.
(ii) Schedule II includes 42 Schedule I mines that are currently under production or about to start production.
(iii) Schedule III mines includes the 32 Schedule I mines that have been earmarked for a specified end-use.

2.3.1 FDI in Coal Sector

In respect of the coal sector, FDI under the automatic route is circumscribed by several conditions. FDI is allowed only in relation to coal and lignite mining for captive consumption by power projects, iron and steel, cement units and other eligible activities permitted under and subject to the provisions of the Coal Mines (Nationalization) Act, 1973. Furthermore, the setting up coal processing plants like washeries subject to the condition that such a company shall not do coal mining and shall not sell washed coal in the open market.

2.4 Petroleum and Petroleum Products

India has a detailed legal framework governing aspects ranging from prospecting and extraction of petroleum, acquisition of land and land rights for petroleum

projects, production, refining and blending of petroleum, storage, import, transportation and sale of petroleum.

The Petroleum and Natural Gas Regulatory Board ("PNGRB") is a statutorily constituted regulatory authority that has the power to grant authorisation for the development, operation and maintenance of petroleum and petroleum product pipelines and regulate the Transportation Tariff charged for the use of such pipelines.

Prospecting and extraction of petroleum is governed by the New Exploration and Licensing Policy (NELP), under which a competitive bidding process is undertaken annually. The selected entities have to enter into a Production Sharing Contract ("PSC") and a Joint Operating Agreement ("JOA") that collectively regulates the exercise of the prospecting and extraction rights vested with such entity with the Government. The provisions of the PSCs under NELP prohibit export of any petroleum oil discovered pursuant to PSC.

India had adopted the Production Sharing Contract approach under NELP under which the cost incurred in exploration and production by the entity is first recovered from the oil/gas produced from the well and only thereafter is the government share and the entity's share provided. Although India has one of the more attractive PSC structures in the world, it has failed to attract large scale investments in light of the various implementation issues, particularly audit disputes that arise between the entities and the Government over determination of the cost and expenses that should be recovered from the petroleum produced before the government share is determined. There are a very large number of PSC related arbitration disputes in existence.

It is in light of the implementation difficulties and fall in interest in the PSC structure, the Government of India recently (in March 2016), announced a shift to the Revenue Sharing Model in the new exploration and licensing policy named "Hydrocarbon Exploration and Licensing Policy" (HELP), that would reduce the requirement of government audit to determine costs. The attraction of the revenue sharing model, is that since the costs and expenses incurred in discovering and producing oil/gas from a given area are at the risk of the entity, the Government will not require to audit the same and the Government would obtain a straight share in revenue from the sale of the petroleum. The existing PSCs will continue to be applicable and continue to govern the specific fields allotted thereunder.

While there is no general regulation governing sale price of petroleum, the Union Government regulates the price at which petroleum is sold by the main public sector undertakings (IOCL, BPCL and HPCL) that dominate the market of sale of petroleum. The Government also regulates the price at which petroleum and natural gas can be sold by companies that have been granted authorization pursuant to the NELP.

2.4.1 FDI in Petroleum Sector

One hundred percent FDI under the automatic route[22] is allowed in respect of:

- Exploration activities of oil and natural gas fields,
- Infrastructure related to marketing of petroleum products and natural gas,
- Marketing of natural gas and petroleum products,
- Construction of Petroleum product pipelines, natural gas pipelines, LNG regasification infrastructure,

Petroleum refining in the private sector. However, in respect of petroleum refining by public sector undertakings (PSUs),[23] without any dilution of domestic equity or disinvestment by government, FDI limited to 49 % under automatic route.

2.5 Natural Gas, and LNG

The Natural gas sector is governed by the same legal framework as for petroleum oils and petroleum products as discussed above. Broadly the regulatory framework can be summarized as follows:

- The LNG sector is regulated to the extent that entities seeking to establish LNG Import Terminals are required to be registered with the PNGRB pursuant to the PNGRB (Eligibility Conditions for Registration of Liquefied Natural Gas Terminal) Rules, 2012.
- Gas Transmission and Distribution is regulated by the PNGRB and any entity undertaking or seeking to undertake establishment, operation and maintenance of gas pipelines requires to take authorization from PNGRB. The PNGRB also regulates the tariff that can be charged for transportation of gas by pipeline companies.
- City Gas Distribution is regulated by the PNGRB, and any entity undertaking or seeking to undertake establishment, operation and maintenance of city gas distribution network requires to take authorisation from PNGRB. The PNGRB also regulates the tariff that can be charged by city gas distribution companies.

[22]'Automatic route' in respect of FDI means that no prior government approval is required for making an investment. This is in contrast to the 'approval route' which is subject to prior government approval.

[23]"Public Sector Undertakings" are industrial undertakings owned by either the Union Government or State Government.

3 Evolution of the Doctrine of Public Trust with Regard to Natural Resources

Four core principles laid down under the Constitution of India have formed the basis of the doctrine of 'Public Trust' with regard to governance of natural resources in India. These provisions are extracted below:

> ***Article 21 Protection of Life and Personal Liberty***: *No person shall be deprived of his life or personal liberty except according to procedure established by law.*
>
> ***Article 39 Certain Principles of Policy to be followed by the State***: ...
>
> (*b*) *The State shall, in particular, direct its policy towards securing that the ownership and control of the material resources of the community are so distributed as best to subserve the common good*."
>
> ***Article 48A***: *The State shall endeavor to protect and improve the environment and safeguard the forest and wildlife of the country.*
>
> ***Article 51A Fundamental Duties***: *It shall be the duty of very citizen of India ...*
>
> (*g*) *to protect and improve the natural environment, including forests, lakes, rivers and wild life and to have compassion for living creatures.*

3.1 Emergence of Public Trust Doctrine in Environmental Law Cases in India

The doctrine of public trust was articulated for the first time by the Supreme Court in 1997 in the case of M.C. Mehta v. Kamal Nath,[24] the Supreme Court held that the Government had committed breach of public trust by leasing ecologically fragile land to a hotel. The issue before the Court in that case was the legality of the government's decision to regularize encroachment of reserved forest land by a private hotel in the state of Himachal Pradesh. The hotel had also tried to change the course of the river Beas on the banks of which the hotel was situated, so as to prevent instances of flooding and loss of property. The environmental clearance in respect of the land was quashed, the forest land had to be returned to the trust of the state, and the private hotel had to pay a significant fine. Before this judgment, the Supreme Court of India had made references to the Directive Principles Of State Policy but never formulated principles that would make them enforceable. The Supreme Court, as early as 1981, had observed "*Rivers, forests, minerals and such other resources constitute a nation's wealth. These resources are not be frittered away and exhausted by one generation. Every generation owes a duty to all*

[24] *M.C. Mehta v. Kamal Nath* (*1997*) *1 SCC 388*. The case was against property held by one of India's former ministers – Mr. Kamal Nath (who at that time held the portfolio of the environment ministry, and subsequently the commerce ministry).

succeeding generations to develop and conserve the natural resources of the nation in the best possible way..."[25]

The Supreme Court referred to the origin of the public trust doctrine in the ancient Roman Empire, its position in the English common law and also relied on principles under case laws on public trust in the United States, such as the landmark "*Mono Lake*" case.[26] It held that the public trust is more than an affirmation of state power to use public property for public purposes. It is an affirmation of the duty of the state to protect the people's common heritage of streams, lakes, marshlands and tidelands, surrendering that right of protection only in rare cases when the abandonment of that right is consistent with the purposes of the trust. It noted that: *The State is the trustee of all natural resources which are by nature meant for public use and enjoyment. The State as a trustee is under a legal duty to protect the natural resources. These resources meant for public use cannot be converted into private ownership*.[27] However, such observations were not ratio and not enforced as such. The MC Mehta case was the first judicial pronouncement enforcing and clearly formulating the public trust doctrine in India.

This principle, which initially evolved in the context of the State's duty to protect the environment,[28] has been relied on progressively in the context of ownership and use of a wide range of natural resources. This is in contrast to what appears to be a far more limited application of the doctrine in the United States, where it has been confined to tidal waters, inland navigable waterways and fish and wildlife resources.[29]

3.2 Public Trust Over Oil and Gas Resources

The public trust doctrine in the country's oil and gas resources emerged in the context of another recent ruling in 2010 in a dispute between two privately owned oil companies in India- RIL (Reliance Industries Limited) and RNRL (Reliance

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[25] *State of Tamil Nadu v. Hindu Stone 1981* (*2*) *SCC 205*.

[26] *National Audubon Society v. Superior Court* (*658 P.2d 709*, *1983*). The California Supreme Court held that the state, under the public trust doctrine, had continuing responsibility for the state's navigable waters and that the public trust doctrine, therefore, prevented any party from appropriating water in a manner that harmed the public trust interest. However, the court also recognized that since the city of Los Angeles depended on diversions of a critical water source, this in turn mitigated the rule of law as the court held that water transfers were permissible even though some damage to the environment would occur as long as this was kept to minimal harm to the extent feasible.

[27] Ibid.

[28] M.I. Builders v Radhey Shyam Sahu AIR 1999 SC 2468; Intellectual Forum v State of A.P (2006) 3 SCC 549; Fomento Resorts and hotels Ltd. v Minguel Martins (2009) 3 SCC 571.

[29] The U.S. Supreme Court has held that States "own" fish and game within their borders on behalf of their citizens: Geer v. Connecticut, 161 U.S. 519, 529 (1896).

Natural Resources Limited).[30] The Government of India to allow limited private sector participation in gas exploration. The Government awarded particular "blocks" to private companies, and this relationship was governed by several contractual documents, principally- the Production Sharing Contract ["PSC"]- which is a standard legal document in the oil and gas exploration sector.

A PSC was entered into between RIL and the Government of India in respect of a oil and gas exploration block in the Krishna-Godavari basin, known as KG-D6 in 1999. In 2003, RIL tendered for the supply of gas to the National Thermal Power Corporation ["NTPC"- which is a state controlled enterprise] won the bid, and entered into an agreement to supply a specified quantity of gas at $2.34/mmBtu. In the meanwhile, differences had begun to emerge between the two main promoters of RIL – Mukesh and Anil Ambani, and a family arrangement/Memorandum of Understanding ["MoU"] was entered into between the two brothers and their mother, on 18 June, 2005, dividing RIL concerns between the brothers. Consequently, the split of interests between "RIL" and "RNRL" was formalized. The MoU gave RNRL a specified entitlement of oil and gas at the price at which RIL had agreed to supply gas to NTPC, i.e., $2.34/mmBtu.

Following this, the RIL and RNRL Boards approved a draft Gas Sale Master Agreement ["GSMA"] and Gas Sale Purchase Agreement ["GSPA"]. However, RNRL subsequently contended that the GSPA and GSMA were inconsistent with the scheme. Subsequently, the Ministry of Petroleum and Natural Gas of the Government of India declined to approve RIL's request to supply gas to RNRL at the NTPC price of $2.34/mmBtu. Legal proceedings therefore commenced at the Bombay High Court to resolve the dispute.

In August 2007, without prejudice to the decision of the Court, an Empowered Group of Ministers adopted a price formula that prescribed $4.20 as the ceiling, and applicable when the cost of oil is $60/barrel or more. The dispute finally reached the Supreme Court, before which several complex issues arose in relation to the enforcement of the private arrangement between two companies, and the interests of the Government of India. The main principles that emerged from the reasoning applied by the Supreme Court are summarized below[31]:

(i) That a private contractual arrangement or MOU between two private actors cannot over-ride considerations of national interest, natural resources etc., which are relevant in formulating a "suitable arrangement" for gas supply;
(ii) The power of the Government to distribute natural resources for the good of the community overrides private agreements. In this respect, the Court invoked the principles under the Constitution of India cited earlier, as well as the international principle of permanent sovereignty over natural resources adopted by the UN General Assembly in Resolution 1803, and the doctrine of public trust.

[30]Reliance Industries Limited v. Reliance Natural Resources Limited (2010) 7 SCC 1.

[31]Paras 86–88.

(iii) Specifically on the issue of public trust, the Supreme Court held that: *It is relevant to note that the Constitution envisages exploration, extraction and supply of gas to be within the domain of governmental functions. It is the duty of the Union to make sure that these resources are used for the benefit of the citizens of this country. Due to shortage of funds and technical know-how, the Government has privatized such activities through the mechanism provided under the PSC*. PSC gives the power to the Government not only to determine the basis of valuation of gas, but also its price... The transactions between RIL and RNRL are subject to the over-riding role of the Government.

(iv) The natural resources are vested with the Government as a matter of trust in the name of the people of India. Thus, it is the solemn duty of the State to protect the national interest.

3.3 Public Trust in Relation to the India's Airwaves: The 2G Case Law in India

The Supreme Court ruling in *Centre for Public Interest Litigation v Union of India* (hereafter '*2G case*')[32] arose in the context of the auctioning of the 2G spectrum to telecom companies in India. The Department of Telecommunications (DoT) had relied on allocation of spectrum for 2G telecommunication services on a "first come- first serve" basis. The DoT has the power to issue telecom licenses under the proviso to section 4(1) of the Indian Telegraph Act 1885, which does not specify the method or manner in which the licenses must be issued. The National Telecom Policy 1999, which also governs the telecom sector, does not mandate auctions. In other words, the law or policy does not mandate auctions and leaves it to the executive to determine the mode of spectrum allocation.

The Supreme Court, relying on its previous decisions in RIL v. RNRL and the Kamal Nath case, held that the radio spectrum in the 2G band qualifies as a "scarce natural resource". It held that the DoT's method of allocation resulted in misallocation/misuse of the scarce resource – and deliberately kept underpriced. It therefore recommended that the alternative method of allocation of spectrum through public auction, would have ensured spectrum allocation to deserving parties who needed it to provide telecom services, and at the same time would have yielded high revenue to State. It held that the State is the legal owner of the natural resources as a trustee of the people and although it is empowered to distribute the same, the process of distribution must be guided by the constitutional principles including the doctrine of equality and larger public good.

Pursuant to its decision, the Supreme Court cancelled the allocation of 122 spectrum licenses for the 2G spectrum. This resulted in a spate of threats of international investment arbitration claims, of which claims with regard to 21 licenses of Loop

[32](2012) 3 SCC 1.

telecom, promoted by a Mauritian based company- Khaitan Holdings Mauritius Limited (KHML), under the India-Mauritius Bilateral Investment Treaty, is currently pending adjudication. Two other companies- Sistema from Russia, and Telenor, through its Norwegian and Singapore subsidiaries, had earlier served notices under the India-Russia Bilateral Investment Treaty, and the India-Singapore Comprehensive Economic Cooperation Agreement, for international arbitration, but had not followed up after buying back the spectrum through government held auctions.

The impact of the 2G spectrum case was diluted to an extent in a subsequent Presidential reference with regard to the implications of the judgment for all other natural resources. The Supreme Court in *In re Special Reference No 1 of 2012* (hereafter '*2G Reference*')[33] clarified that the requirement for holding a public auction was limited to the specific facts of the 2G case (i.e., distribution of spectrum), and not to all natural resources. It also noted that while an auction was a legitimate method if the objective of distribution was to raise maximal revenue, it was also open to the government to set goals other than revenue maximisation, consistent with the common good. In such cases, clearly, an auction might not be the best method of distribution.

3.4 Impact of the Public Trust Doctrine on Natural Resource Governance

The public trust doctrine has been made an integral part of regulating natural resources under Indian law. The public trust doctrine which is a limited doctrine in the US law was adapted into India law by the Supreme Court and has been expanded to impose "an implicit embargo on the right of the State to transfer public properties to private party if such transfer affects public interest, mandates affirmative State action for effective management of natural resources and empowers the citizens to question ineffective management thereof."[34] The Supreme Court of India has held that "the constitutional mandate is that the natural resources belong to the people of this country.[35]"

In relation to natural resources the Indian Supreme Court has held: "As natural resources are public goods, the doctrine of equality, which emerges from the concepts of justice and fairness, must guide the State in determining the actual mechanism for distribution of natural resources. In this regard, the doctrine of equality has two aspects: first, it regulates the rights and obligations of the State vis-à-vis its people and demands that the people be granted equitable access to

[33](2012) 10 SCC 352.

[34]Fomento Resorts and Hotels Ltdv. Minguel Martins (2009)3SCC 571.

[35]Centre for Environment Law, WWF-I v. Union of India (2013) 8 SCC 234; Reliance Natural Resources Limited v. Reliance Industries Limited (2010)7SCC 1.

natural resources and/or its products and that they are adequately compensated for the transfer of the resource to the private domain; and second, it regulates the rights and obligations of the State vis-à-vis private parties seeking to acquire/use the resource and demands that the procedure adopted for distribution is just, non-arbitrary and transparent and that it does not discriminate between similarly placed private parties."

This express expansion of the public trust doctrine was undertaken by the Indian Supreme Court to specifically counter the use of executive power to increase the scope of private participation in various sectors, without the relevant amendments to the governing statutory framework having been undertaken. The amendments to statutory frameworks could not be possible essentially due to presence of coalition politics since 1990s that had prevented passage of substantive legislative changes.

This aspect is clear in the following observations of the Supreme Court: "What needs to be emphasised is that the State and/or its agencies/instrumentalities cannot give largesse to any person according to the sweet will and whims of the political entities and/or officers of the State. Every action/decision of the State and/or its agencies/instrumentalities to give largesse or confer benefit must be founded on a sound, transparent, discernible and well-defined policy, which shall be made known to the public by publication in the Official Gazette and other recognised modes of publicity and such policy must be implemented/executed by adopting a non-discriminatory and non-arbitrary method irrespective of the class or category of persons proposed to be benefited by the policy. The distribution of largesse like allotment of land, grant of quota, permit licence, etc. by the State and its agencies/instrumentalities should always be done in a fair and equitable manner and the element of favouritism or nepotism shall not influence the exercise of discretion, if any, conferred upon the particular functionary or officer of the State.'[36]

4 Trade Restrictions on Natural Resources

4.1 Import Tariffs on Natural Resources

India, like many other WTO members has bound its tariffs for energy goods at a fairly high level in its GATT Schedule, even though its applied rate of duty is significantly lower. It is also interesting to note that in its FTAs with key partners (ASEAN, Singapore, Korea, Malaysia, SAFTA), India has committed to lower preferential tariffs.

[36]New India Public School v. HUDA (1996) 5 SCC 510.

The following examples provide a snapshot:

HS code [with description]	GATT bound tariff	Applied tariff	Preferential tariff	
261210 – Uranium ores and concentrates	40.0	2.0	Free Trade Agreement duty rate for Korea, Rep. of	1.5
			Free Trade Agreement duty rate for Sri Lanka	0
270750 – Aromatic hydrocarbon mixtures of which >= 65 % by volume, incl. losses, distils at 250 °C by the ASTM D 86 method (excl. chemically defined compounds)	Unbound	10.0	Free Trade Agreement duty rates for Malaysia, Singapore and Thailand under the Association of Southeast Asian Nations (ASEAN)	5
			Free Trade Agreement duty rate for Korea, Rep. of	9.38
			Free Trade Agreement duty rates for Pakistan and Sri Lanka under the South Asian Free Trade Area (SAFTA)	7
			Least Developed Countries (LDC) duties	4
			Free Trade Agreement duty rate for Singapore	2
270799 – Oils and other products of the distillation of high temperature coal tars; similar products in which the weight of the aromatic constituents exceeds that of the non-aromatic constituents (excl. chemically-defined compounds, benzol “benzene”, toluol “toluene”, xylol “xylenes”, naphthalene, aromatic hydrocarbon mixtures of subheading 2707.50, and creosote oils)	Unbound	10.0	Free Trade Agreement duty rates for Malaysia, Singapore and Thailand under the Association of Southeast Asian Nations (ASEAN)	5
			Free Trade Agreement duty rate for Korea, Rep. of	9.38
			Free Trade Agreement duty rates for Pakistan and Sri Lanka under the South Asian Free Trade Area (SAFTA)	7
			Free Trade Agreement duty rates for Bangladesh, Bhutan, Maldives and Nepal under the South Asian Free Trade Area (SAFTA); Free Trade Agreement duty rate for Sri Lanka	0
			Least Developed Countries (LDC) duties	4
			Free Trade Agreement duty rate for Singapore	2

4.2 Export Restrictions

India regularly maintains export taxes on iron ore, which is currently at the rate of 30 %, and on bauxite ore, which is at 20 %. One of the fall-outs of the iron ore tax has been the accumulation of iron ore mined in certain parts of India (like the state of Goa), which has low iron content, and which Indian companies do not have the technology to exploit.

India has also been imposing export taxes on chromite in order to provide a greater supply of this mineral to the domestic market. India is a major country engaged production and export of chromite. The applicable export duty on this is 30 %.

India has so far firmly resisted any demands from its FTA trading partners on undertaking commitments on not imposing export taxes.

Another aspect to note, as discussed above, is that the provisions of the production-sharing contracts (PSCs) under policy for petroleum exploration (NELP) prohibit export of any petroleum oil discovered pursuant to PSC and this policy will continue under the revenue sharing contract to be entered into under the new Hydrocarbon Exploration and Licensing Policy (HELP).

5 Conclusion

In summary, natural resources exploitation is subject to governmental control over allocation and distribution of such resources. While foreign investment in sectors such as petroleum and mining is allowed without any equity caps and restrictions, the domestic regulatory framework vests the government with powers regarding extent of control and utilization of such resources by private sector players. India also maintains import and export restrictions.

Part II
Export Restrictions and WTO Agreements

Chapter 5
A Note on the China Rare Earths Case

Mitsuo Matsushita and Thomas J. Schoenbaum

Abstract The World Trade Organization's dispute settlement mechanism has considered and decided several cases involving export restrictions. Among these cases the most important and most recent is the China Rare Earths Case. In this paper the authors analyze and evaluate the panel and Appellate Body opinions in the Rare Earths Case. Three points are especially important. First, the case brings out the fact of the disparity between import and export measures in the law of the WTO. Unlike import measures, WTO discipline with respect to export measures is haphazard, inconsistent and unfair. Second, the case highlights the issue of the relationship between WTO Accession Protocols and the WTO Agreement. The authors dispute the conclusion of the Appellate Body that the rules of the GATT, specifically the general exceptions, do not apply to certain parts of China's Accession Protocol. Third, the case shows the limitations that apply under WTO law with respect to conservation measures of natural resources that move in international trade.

Keywords Chinese natural resources • Rare earths • WTO accession protocol

1 Introduction

In 1972, the Club of Rome issued a report entitled as "The Limits to Growth"[1], which gave warning to the world that, due to the lack of natural resources, world economic growth would be halted within 100 years. This warning, together with the Oil Crisis in 1973, precipitated by the move of the OPEC to cut the production of crude oil and increase the price, attracted much attention of the governments,

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[1]Donella H. Meadows et al. (1972). The Limits to Growth.

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_5

industries, consumers and the general public in major countries. Nevertheless, the 1970s and 1980s was a period of economic growth in major countries. In the 1980s, the Uruguay Round of GATT Trade Negotiation began and culminated in the establishment of the World Trade Organization in 1994. In this optimistic atmosphere, the warning of the Club of Rome and the lessons of the Oil Crisis were forgotten.

However, in the past decade or so, the potential threat of lack of natural resources is creeping in again. This is caused by a tremendous explosion of the world population and the rapid economic growth of emerging economies and newly industrialized countries. The specter of climate change has the potential to affect adversely both agriculture and water supplies. Once again problems of scarcity of natural resources are looming for companies and nations alike.

In reflection of a grim prospect of relative scarcity of natural resources, many countries have recently adopted international trade measures with a view to restrict exportation of natural resources and to keep them within their territories. Some countries have adopted of a policy of preserving natural resources at home to promote industries that use them to produce finished products and export them abroad. For this and other reasons, one can see the trend toward restricting export of natural resources among some natural resources-holding countries. These trade restrictions in some cases have been challenged at the WTO. The latest case of this type is *China—Measures Relating to the Exportation of Rare Earths*, *Tungsten and Molybdenum*,[2] which is the subject of this note.

2 GATT Disciplines on Export Restrictions

Broadly speaking, there are two kinds of export restrictions, i.e., export duties and export quotas.

2.1 Export Duties

In marked contrast to import duties, the GATT 1994 does not impose any prohibition or restriction on export duties. Whereas, in regard to import duties, GATT Article 2:1 requires WTO members to create schedules of tariff concessions, and WTO members are obliged to limit their import duties accordingly, there is no comparable obligation regarding export duties. Therefore, WTO members are free to impose export duties at will except for the countries that promised in their accession protocols to enter the WTO that export duties would be abolished or limited. It is not clear why there is this asymmetry between import and export

[2]WT/DS431,432,433, Report of the Panel (2014) and Report of the Appellate Body (2014).

duties. It is perhaps due to the fact that the framers of the GATT 1947 (the predecessor of the GATT 1994) were so preoccupied with reducing import duties and import restrictions that the control of export duties was not their priority.

2.2 *Export Quotas*

Article XI of the GATT prohibits, in principle, the imposition by WTO members of export quotas as well as import quotas. This Article provides: "No prohibitions or restrictions other than duties. . .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." (underlining supplied). Nevertheless, many exceptions are attached to this prohibition. Major exceptions are: (1) temporary export prohibitions or restrictions of essential products in order to prevent or mitigate their critical shortage (GATT: XI:2 (a)); (2) measures necessary for the application of standards on classification, grading or sale of products (GATT XI (c)); (3) measures necessary for the protection of the life and health of humans, animals and plants (GATT: XX(b)); (4) measures necessary for the observance of laws and regulation which do not infringe GATT provisions (GATT: XX(d)); (5) export prohibition of gold and silver (GATT: XX(c)); (6) measures relating to products of prison labor (GATT: XX(e)); (7) measures to protect national treasures of artistic, historical and archeological value (GATT: XX(f)); (8) measures relating to the conservation of exhaustible natural resources (GATT: XX(g)); (9) measures taken in connection with duties provided in inter-governmental commodity agreements (GATT: XX (h)); (10) measures to restrict export of products necessary for the implementation of low-price policy in order to stabilize their domestic price (GATT XX(i); and (11) measures essential to the acquisition of products in short supply (GATT XX (j)).

In addition to the above, Article XXI of the GATT provides that WTO members can take measures including export prohibitions or restriction of products for the purpose of national security. Jackson and Davey state that, given this many exceptions, it can hardly be said that export prohibitions are of crucial importance.[3]

[3]John H. Jackson, William Davy & Allan Sykes: The Law of International Economic Relations (West., 3d Ed., 1995), p. 945.

3 WTO/GATT Dispute Settlement Cases Preceding the China Rare Earths Case

Compared with the area of import restrictions (safeguard, antidumping and countervailing duties), there have been relatively few cases in which export restrictions were argued and decided according to the dispute settlement procedures of the WTO/GATT. To the knowledge of the writers, previous cases include only the *Japan Trade in Semiconductor Case*,[4] *the Argentina Bovine Hides and Leather Case*[5] and the *China Minerals Export Case*.[6] Among those, the issues in the *China Minerals Export Case* are similar to those in the *China Rare Earths Case* and are referred to by the Panel and the Appellate Body reports; thus, brief comments are worth making about this case.

In the *China Minerals Export Case*, export restrictions imposed by China on nine minerals (bauxite, silicon, manganese, etc.) were at issue. China imposed export duties on some of them and export quotas on some others. The U.S., EU and Mexico filed complaints with the WTO arguing that such impositions infringed the GATT: XI: 1. China defended on the grounds that its export restrictions were exempted from GATT disciplines by virtue of GATT: XX(b) and (g). Both the WTO panel and the Appellate Body disagreed with China's contentions.

A major issue in this case was that of export duties. China had promised in Para 11.3 of the Accession Protocol for its entry into the WTO that it would abolish all export duties except for those items listed in Annex 6, and the minerals in question in this case were not included in those exempted items. When challenged at the WTO dispute settlement procedure, China argued that the export duties were justified by GATT: XX(b) and (g). However, the Panel and the Appellate Body rejected this defense on the ground that, whereas other Paragraphs in the Accession Protocol (for example, Para 5 on the liberalization of trade in audio-visual instruments) refer to the right of China under the GATT 1994, Para 11.3 does not refer to that right, and *a contrario* interpretation should be that China could not invoke the rights under the GATT (such as the rights) in respect of Para 11.3.

With respect to whether the export quotas that China imposed could be justified by GATT: XX(b), both the Panel and the Appellate Body ruled that China could not invoke this exception to justify its position because the evidence adduced by China did not establish that the export quotas were primarily aimed at the avoidance of hazards to human life and health.

Another issue was whether China could invoke GATT: XX(g) to justify its position. On this, the Panel and the Appellate Body held that, under GATT: XX (g), export quotas must be put into effect in conjunction with restrictions on

[4] Japan-Trade in Semiconductors, adopted 4 May 1988, BISD 355/116.

[5] Argentina-Measures Affecting the Export of Bovine Hides and Finished Leathehr, WT/DS155/R/ DSR 2001, V, 1770.

[6] China-Measures Relating to Exportation of Various Raw Materials, WT/DS394/R: WT/DS395/ R; WT/DS398/R, 5 July 2011.

domestic production or consumption of the minerals in question, and that, in this case, such domestic restrictions were not implemented, and that, therefore, there was no evenhandedness between export restrictions and domestic restrictions.

Finally, China argued that the measures in question were permitted under GATT: XI: 2 (a), which justifies export restrictions to deal with critical shortage of essential products such as foods. But the Panel and the Appellate Body responded that the requirements for invoking GATT: XI: 2 (a) are the critical shortage of products in question and the temporary nature of the measure. However, both of these requirements were lacking in the arguments of China.

The *China Minerals Export Case* immediately preceded the *China Rare Earths Case*, and the Panel and the Appellate Body in the latter case often referred to the rulings of the earlier case. A major difference between the two cases, however, is that, in the *China Minerals Export Case*, China did not restrict domestic production and consumption of the minerals in question, but in the *China Rare Earths Case*, China did restrict domestic production of rare earths and other minerals. So the issue in the *China Rare Earths Case* is how much restriction of domestic production is necessary and the timing of export and domestic restrictions, issues that were not raised in the *China Minerals Export Case*.

4 The Panel Report in the China Rare Earths Case[7]

4.1 Export Duties

China imposed export duties ranging from 5 % to 25 % *ad valorem* on rare earths, tungsten and molybdenum ("the three items"). China did not contest the fact that the three items of which China made a promise to repeal export duties were not included in Annex 6 of the Accession Protocol which carved out certain items from the promise. China argued that the imposition of export duties would be justified by GATT: XX(b), which exempts from GATT disciplines measures necessary to protect the life and health of humans, animals and plants.

The Panel rejected the claim of China for the following reasons. Although the WTO Accession Protocol is an integral part of the WTO agreements, paragraph 5.1 and paragraphs 162 and 165 of the Report of the Working Party clearly state that China's rights and obligations under the GATT would not be affected. Moreover, in its decision in the *China-Audio Visual Case*,[8] the Appellate Body based its ruling that China was entitled to invoke GATT: XX to justify its position based on the fact that Para 5.1 refers to the rights and obligations of China under the GATT. The

[7]China-Measures relating to the Exportation of Rare Earths, Tungsten and molybdenum, Report of the Panel, 26 March 2014, WT/DS431/R; DS432/R; DSD433/R.

[8]China-Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products, WT/DS363/AB/R, adopted 19 January 2010.

Panel in the *Rare Earths Case* emphasized that Para 11.3 had no such reference to the rights and obligations of China under the GATT 1994, and *a contrario* interpretation requires the Panel to hold that GATT: XX cannot be invoked in respect of Para 11.3. The Panel points out that, if the invoking of GATT: XX in respect of Para 11.3 were to be upheld, other provisions in the Protocol that refer to the rights and obligations of China would have no meaning.

The Panel also took note that Para 2.1 of the Accession Protocol, which states that the Accession Protocol is an integral part of the WTO agreements. The Panel held, however, that this paragraph only shows that the Protocol was integral to the WTO agreements and does not necessarily mean that all provisions incorporated in the WTO agreements are applicable to all provisions contained in the Protocol.

In this way, the Panel applied a literal interpretation to the relationship between Para 11.3 and the WTO agreements and came to the conclusion that GATT: XX did not apply to it. This said, however, the Panel went on to discuss whether the export duties which China imposed on the three items would be justified under GATT: XX (b) if, for the sake of argument, it applied. China argued that the extraction of the three items gives harmful effects on the environment as well as on human bodies, and China has taken measures to prevent the worsening of the situation. It argued further that the imposition of export duties on the three items would result in the reduction of their production and, therefore, would be justified under GATT: XX (b). The Panel stated that China had not shown in what way the imposition of export duties on the three items would improve the environment and reduce risks to the human body. On the contrary, the Panel argued, that the imposition of export duties on the three items would cause a rise in their export prices, and, in turn, this would result in a reduction of their domestic prices, and domestic industries would increase production of processed products using the three items as ingredients. The Panel concluded that this would promote rather than restrict their consumption.

4.2 Export Quotas

China did not contest that export quotas infringed GATT: XI: 1 and argued that it should be exempted from GATT disciplines by virtue of GATT: XX(g). GATT: XX (g) provides 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 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:

. . .

(g) relating to the conservation of exhaustisble natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

GATT: XX(g) requires, as constituent elements, that (1) the subject matter of the measure in question is exhaustible natural resources, (2) the measure in question relates to the conservation of exhaustible natural resources, (3) the measure is implemented in conjunction with domestic restrictions of production or consumption of the natural resources and (4) such measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.

The Panel examined whether the export quotas in question are concerned with exhaustible natural resources; what is the conservation of natural resources; whether the export quotas in question relate to conservation; whether they are implemented in conjunction with the restriction of domestic production or consumption; and whether, when enforcing export quotas, evenhandedness is maintained between domestic and foreign purchasers. Now we focus on the most important of these points.

4.3 The GATT Article XX(g) Requirements

The Panel stated that the "relating to" requirement need not be interpreted so narrowly as to mean "primarily aimed at", but there should be "a reasonable relationship" or "a substantial relationship" between the measure in question and its aim. After examining the details of Chinese laws and regulations of the three items, the Panel came to the conclusion that the Chinese measures did not satisfy this reasonable or substantial relationship requirement.

Chinese laws and regulations on the three items cover a wide range of matters such as national security, the protection of human, animal and plant life and health, environmental protection, the public interest and establishment and promotion of specific industries. Export quotas are explained as part of this regulatory regime. In the Panel's view, China did not clearly prove that the regulatory regime related to the conservation of the three items and, just by analyzing those laws and regulations, it could not be established that the export quotas have a substantial or reasonable relationship to the conservation of those natural resources.

In the Chinese export regime, an unused export quota for exports allocated to one period could not be carried over to the next period. Rather, this unused quota was allocated to domestic consumption. The Panel argued that this measure would cause the price of the three items to rise outside China, whereas the domestic price would be lower, promoting additional use and consumption of the resources inside China. Regarding the fact that China enforced restrictions on new entry into the production of the three items, the Panel stated that this regulation only limited the entry of new enterprises and did not result in the limitation of extraction of the three items by existing domestic users.

Another argument of China was that it imposed quotas on the excavation and production of the three items, and this amounted to a restriction of production. The

Panel rejected this claim for the following reason. China limited the excavation and production below the level of previous period. However, this alone does not constitute a restriction of production in the sense of GATT: XX(g) because the level of demand may have decreased even more, and the reduced level of production may still be more than that demand. This would mean that there was still a surplus in the domestic market. In a real restriction of production, the level of production has to be lowered below the projected demand for the period concerned (for example, the next 1 year period). But this is not what China did. In 2012, Chinese excavation and production did not reach the quota allocated for this period; this must have been because the quota was set above the real demand.

The Panel made these observations and further stated that the actual effect of this regulation was to lower the domestic price of the three items, thereby ensuring a more-than-sufficient supply at resulting low prices to domestic users. The Panel concluded that this could hardly be said to be a restriction of domestic production or consumption exercised in conjunction with export restriction in the sense of GATT: XX(g). The Panel further noted that China did not set a limit to domestic consumption of the three items and, as noted earlier, any unused export quota could be used for domestic consumption. Since there was no limitation to the domestic consumption, the unused export quota would be used to promote domestic consumption.

China also argued that it imposed a natural resources tax on the three items and this should set a limit to domestic extraction and production. The Panel responded that China did not clearly prove in what way and how much the natural resources tax had the effect of limiting extraction and production.

China also established environmental standards, such as emission standards, with regard to the extraction and production of the three items, and only enterprises that satisfy these standards are permitted to enter the extraction and production of the three items. China also provided subsidies to enterprises that satisfied such standards. The Panel stated that, although the Chinese efforts to promote environmental improvement through such measures were highly commendable, they were not a limitation of extraction and production and did not amount to a restriction on production or consumption in the sense of GATT: XX(g).

The Panel ruled that export quotas and restriction of domestic production and consumption must be enforced in parallel way and simultaneously. However, the Chinese measures on export quotas, extraction quotas and production quotas were not enforced in parallel way and not simultaneously. This disparity among the three kinds of quotas (export quotas and restrictions on domestic production and consumption) would cause instability in trade of the three items and may cause hoarding and illegal transactions. The export quotas for the year 2012 were not used up and the part that was not used up must have been allocated to domestic consumption. China imposed export quotas first and then later imposed restrictions on extraction or production of the three items. This meant that even if exporters were allocated export quotas, there was no guarantee that they could get supply to fulfill such quotas. Placing exporters in such an unstable position may have been the reason for the non-fulfillment of export quotas. If so, the unused export quotas were allocated to domestic consumption. Moreover, export quotas on the three items

began in 2001, whereas quotas on extraction and quotas on production started in 2007. This interval of 4–5 years cast doubt on the Chinese claim that export quotas, extraction quotas and production quotas worked hand-in-hand.

After enumerating those reasons, the Panel concluded that the Chinese measure was an industrial policy measure designed to secure supply of the three items to domestic industries rather than an assurance for exporters that a certain portion of the product would be secured for export, and that there was no evenhandedness between export quotas and domestic production restriction and that no reasonable relationship between the export restrictions and domestic measures could be recognized. The Panel added also that the export of products that are made from the three items enjoyed reimbursement of the value-added tax on such products. This was another sign that the Chinese export restrictions of the three items were in reality industrial policy measures.

4.4 Trading Rights

The claimants argued that China made a commitment in the Accession Protocol and the Report of the Working Parties to abolish restrictions on the trading rights exporters and the export restrictions in question were contrary to this commitment and constituted an infringement of the Accession Protocol. The Panel held that China could invoke GATT: XX(g) to justify this infringement, but China did not adduce any claim and evidence that it would be exonerated by virtue of GATT: XX (g), and therefore the Panel found an infringement of the Accession Protocol on this point.

5 The Appellate Body Report on the China Rare Earths Case

Both China and the U.S. appealed the Panel Report. Although the U.S. was a winning party in this dispute, it appealed for the reason that the Panel unduly disregarded pieces of evidence and this amounted to an infringement of Article 11 of the Dispute Settlement Understanding (DSU). However, the U.S. appeal was conditioned on whether the appeals of the claimants/appellants would be approved and, if they were approved, the U.S. would withdraw the appeal.[9] Since the Appellate Body approved most of the claims of the complainants/appellants, the Appellate Body did not rule on the U.S. appeal.

[9] Inside U.S. Trade, “U.S. Appeals WTO Rare Earths Ruling; China Appeals GPX Panel Report”, April 9, 2014.

5.1 Export Duties

The Appellate Body went on to examine the content of Article XII of the WTO Marrakesh Agreement in order to determine the relationship between the Accession Protocol and GATT: XX. Article XII of the Marrakesh Agreement provides for the entry of new members into the WTO, and, according to Article XII:1: first sentence, the WTO may enter into an agreement with a newly joining member. Article XII further states that the accession agreement applies both to the WTO Marrakesh Agreement and the Multilateral Trade Agreements (Annexes), e.g., when a new member enters into the WTO, the rights and obligations of the WTO Marrakesh Agreement and the Multilateral Trade Agreements apply to that member. Therefore, in accordance with the principle of single undertaking, the act of entry applies to the rights and obligations of both agreements. The Appellate Body reasons that this conclusion follows from Article II:2 of the Marrakesh Agreement which states that the Multilateral Trade Agreements are "an integral part" of the Marrakesh Agreement binding on all Members.

China argued that, taking all of those agreements into account, the conditions stipulated in the Accession Protocol (including "WTO plus") apply to the Marrakesh Agreement and the Multilateral Trade Agreements, and the special rules provided in the Accession Protocol are given priority over other agreements according to Article 30 of the Vienna Convention. The Appellate Body (as well as the Panel) rejected this argument by stating that Article II:1, second sentence, of the WTO Marrakesh Agreement merely means that the act of entry into the WTO applies both to the Marrakesh Agreement and the Multilateral Trade Agreements; that is, it builds a bridge between them, and it does not necessarily mean that the conditions and special rules incorporated in the Accession Protocol are also incorporated into the Multilateral Trade Agreement.[10]

Article 1.2 of China's Accession Protocol states that "the Accession Protocol. . .shall be an integral part of the WTO Agreement", and China argued that "WTO Agreement" included both the Marrakesh Agreement and the Multilateral Trade Agreements. However, the Appellate Body, upholding the Panel, held that this provision only declares that the Accession Protocol is, on the whole, an integral part of the Marrakesh Agreement and does not mean that the conditions and terms contained in the Accession Protocol are incorporated into the Multilateral Trade Agreements. The Appellate Body stated that, by this provision, that the Accession Protocol and the Marrakesh Agreement, on the one hand, and the Multilateral Trade Agreements on the other, became an integrated whole, but the relationship between each provision in the Accession Protocol and the Marrakesh Agreement and the Multilateral Trade Agreements has to be examined separately and decided on a case-by-case basis.[11]

[10]China-Measures Relating to the Exportation of Various Raw Materials, WT/DS395/AB/R; WT/DS395/AB/R; DS398/AB/R (hereafter referred to as China-Rare Earth), Para 5.32.

[11]China- Rare Earths, Paras 5.42, 5.44, 5.45, 5.49.

The Appellate Body reasoned that the mere fact that there is a reference in a provision in the Accession Protocol to the Multilateral Trade Agreements does not automatically enable all provisions in the Annexes including GATT: XX to be applied to it. Likewise, the mere lack of a reference does not automatically disqualify all provisions in the Multilateral Trade Agreements from being applied to it. However, the Appellate Body ruled, after closely examined the content of Para 11.3 of the Accession Protocol, that GATT: XX(g) did not apply to Para 11.3 of the Accession Protocol for the following reasons. Para 11.3 provides that China will eliminate all export duties except for those items listed in Annex 6 of the Protocol. Annex 6 provides for the maximum of export duties to be imposed on 84 items and China promises that it would not raise export duties above this level. In this way, Para 11.3 contains exceptions, and limitations are attached to those exceptions. From this, the Appellate Body reasoned, Para 11.3 cannot not be interpreted to contain more exceptions such as GATT: XX exception[12].

As discussed above, the Appellate Body ruled that, although the Accession Protocol is an integral part of the Marrakesh Agreement and the Multilateral Trade Agreements, the latter does not necessarily apply to each provision of the Accession Protocol. Whether or not they apply should be decided on the basis of the nature of each provision in the Accession Protocol on a case-by-case basis. After reviewing the details of Para 11.3, the Appellate Body concluded that GATT: XX did not apply to Para 11.3 and, therefore, the Chinese export duties could not be justified by GATT: XX(g).

5.2 *Export Quotas*

A question with regard to export quotas is the meaning of the “relating to” requirement in GATT: XX(g), which provides that export quotas are allowed only when they are “relating to” the conservation of exhaustible natural resources. The Panel held that whether a measure is relating to the conservation of exhaustible natural resources should be decided on the basis of design and structure of the measure in question, i.e., whether the measure is not too broad and whether it is reasonably related to the purpose of conservation. The Panel held also that it is not necessarily essential that the measure has had an actual effect of conservation. China argued that the “relating to” requirement should be judged by examining whether a close and genuine relationship exists between the measure and the conservation and that the Panel disregarded the actual effect of the measure by concentrating on the design and structure of the measure only.

The Appellate Body upheld the Panel by stating that, although the Panel emphasized the design and structure of the measure, it did not exclude the effect of that measure on conservation and that the Panel only recommended a case-by-

[12]China- Rare Earths, Para 5.63.

case approach.[13] The Appellate Body concluded that, when deciding whether an export quota is relating to conservation, the main emphasis should be placed on the design and structure of the quota, and an analysis of the actual effect of that measure is not essential; but there is no reason to exclude the effects analysis altogether and that an effects analysis is not necessarily excluded.[14]

Another question is whether the Chinese export quotas were enforced "in conjunction with" the domestic restriction of production or consumption as stipulated in GATT: XX(g). The Panel held that this element requires an examination of (a) whether the export quotas were reasonably related to the restriction of domestic production or consumption and (b) whether evenhandedness between the domestic and foreign purchasers is maintained. China argued that evenhandedness is part of the requirement of "in conjunction with domestic restrictions", that it was not an independent requirement, and that it was wrong for the Panel to require it as if it were an independent requirement.

The Appellate Body observed that whether the Panel held that the evenhandedness was part of the "in conjunction with requirement" or a separate requirement was not clear and unambiguous. The Appellate Body held that the Panel erred insofar as it used an expression which could be interpreted to mean the latter and reversed the Panel to that extent.[15] The interpretation adopted by the Appellate Body is that the evenhandedness requirement is part of the "in conjunction with requirement" and is not an independent requirement. The Appellate Body held that a WTO member intending to enforce an export quota has to enforce real and effective restrictions on domestic production and consumption, but it does not necessarily require absolute equality between the export quotas and the restriction of domestic production or consumption. However, the Appellate Body held that the error of the Panel in this regard was not so fatal so as to cancel the whole report.[16]

Then the Appellate Body turned to the question how to evaluate the export quotas enforced by China in light of GATT: XX(g). China argued that the export quotas and domestic restriction of production that China imposed would give foreign purchasers a message that the supply of the three items would become tight in future and that foreign purchasers should seek alternative resources. However, the Appellate Body pointed out that the export quotas and the restriction of domestic production would give domestic purchasers a message that the three items would be reserved to domestic purchasers and that it would give a message to foreign purchasers that they should shift the site of production of finished products in which the three items were used to China. It stated that, for this reason also, the Chinese measures did not relate to the conservation of exhaustible natural resources as envisaged in GATT: XX(g).

[13] China- Rare Earths, Para 5.108.

[14] China- Rare Earths, Para 5.118.

[15] China- Rare Earths, Para 5.126, 5.127.

[16] China- Rare Earths, Para 5.141.

The Appellate Body also stated that whether the restriction of domestic production of the three items is related to the conservation of exhaustible natural resources depends on the level of the restriction enforced by China and its relationship to the export quotas and, judging from the design and structure of the export quotas and the restriction of domestic production in China, the restriction of domestic production in China did not operate effectively.[17] The Appellate Body propounded as a general proposition the danger that an export restriction of a natural resource in a country may lead to reduction of the domestic price of this resource and promote excess production and consumption of the resource.[18]

In conclusion, the Appellate Body held that, although certain Chinese measures on natural resources including those on the three items are commendable for the purpose of environmental policy, such measures and the export quotas do not operate together so that they impose on both foreign and domestic purchasers an equitable burden and operate for the conservation of natural resources.[19]

6 A Critical Analysis of the Panel and the Appellate Body Reports in the China Rare Earths Case

6.1 Export Duties

The logic and conclusion of the Panel and the Appellate Body on export duties are somewhat tortuous and are not easy to understand. The two Reports (especially the Appellate Body Report) state that the Accession Protocol as the whole is an integral part of the Marrakesh Agreement and the Multilateral Trade Agreements, but that the relationship between a particular paragraph of the Accession Protocol and a provision in the Multilateral Trade Agreements is a separate question and should be decided on a case-by-case approach. They state that a provision in the Multilateral Trade Agreements does not necessarily apply to a paragraph of the Accession Protocol. This seems as if to say that Agreement A (the Accession Protocol) is an integral part of Agreement B (the Multilateral Trade Agreements), but some provisions of Agreement B do not apply to some paragraphs in Agreement B. Then can it be logically said that Agreement A is an integral part of Agreement B? If the Accession Protocol is an integral part of the Multilateral Trade Agreement, can it not be said that provisions of the Multilateral Trade Agreements should apply to paragraphs in the Accession Protocol? If not, what is the meaning of “an integral part”?

One point in the Appellate Body rulings on export duties is especially noteworthy. The Appellate Body stated that whether or not GATT: XX applies to Para 11.3

[17]China- Rare Earths, Para 5.159.

[18]China- Rare Earths, Para 5.194.

[19]China- Rare Earths, Para 5.199.

of the Accession Protocol should not be judged solely on the basis of whether the paragraph in question refers to the Multilateral Trade Agreements, but should be decided by taking into account the whole structure of this paragraph and related contexts. This suggests that this question should be decided on a case-by-case basis, and it follows that, even if a paragraph in the Accession Protocol does not refer to the Multilateral Agreements, still a provision in the Multilateral Trade Agreements (such as GATT: XX) may apply to that paragraph depending on the circumstances. In the *China Minerals Case* referred to earlier, the Appellate Body held that GATT: XX did not apply to Para 11.3 for the reason (perhaps for the only reason) that Para 11.3 did not refer to the Multilateral Trade Agreement. Compared with this stiff formalism, the Appellate Body ruling in the *China Rare Earths Case* on this point is more flexible. The Chinese government took note of this ruling and stated that, although China was disappointed with the conclusion of the Appellate Body in this case, China welcomed the fact that the Appellate Body took a more flexible approach with regard to the question of whether or not GATT provisions apply to paragraphs in the Accession Protocol and would reserve the right to make use of exceptions in the Multilateral Trade Agreements including those in GATT: XX.[20]

Both the Panel and the Appellate Body denied the application of GATT: XX (g) to Para 11.3 of the Accession Protocol for the reason that Para 6 of the Accession Protocol stipulated exceptions to the repeal of export duties provided in Para 11.3, that Para 6 sets a maximum limit to export duties when imposed in accordance with that Para, that Para 11.3 already provided exceptions and that, by reading Para 11.3 and Para 6 together, one must come to the conclusion that the Accession Protocol intended that there would be no more exceptions other than the ones above mentioned.

However, the exceptions incorporated in Para 6 and those in GATT: XX are of a different nature. Para 6 reserves the right of China to impose export duties on 84 items enumerated as exception to Para 11.3 and sets the maximum limit to those export duties and, in this sense, Para 6 is a kind of tariff concession made by China. In contrast, the exceptions in GATT: XX(b) and (g) provide for general exceptions for legitimate reasons such as the protection of life and health and the conservation of exhaustible natural resources that exempt measures amounting to the protection of life and health and the conservation of exhaustible natural resources from the application of GATT disciplines. It seems odd to draw an analogy from tariff concession in Para 6 and Para 11 of the Accession Protocol and apply it to exceptions incorporated in GATT: XX. The issue here is whether China had really agreed to abolish export duties even in the situations where there are legitimate reasons for restrictions such as those envisaged in GATT: XX.

It is not clear why China did not reserve the right to invoke GATT: XX exceptions in respect to Para 11.3 of the Accession Protocol. It may have been a simple mistake in negotiations or China may have had to make this concession to lead the negotiation to success for the entry into accession to the WTO. In any

[20]BNA, WTO Reporter, 2014, 09/08.

event, this lack of reference to the Multilateral Trade Agreements in Para 11.3 is a lacuna in the Accession Protocol and is a good lesson for future entrants to the WTO.

The writers are further of the opinion that the lack of disciplines on export duties in the GATT 1994 is a systemic defect. Some new entrants to the WTO were pressured to abolish export duties or to put some restrictions on the imposition of export duties, while the original WTO members continue to enjoy the right to invoke export duties without limitation. There is a serious imbalance of rights and obligations under WTO agreements among those who abolished or restricted export duties and those who are under no such constraints. This imbalance may, in the long run, lead to erosion of credibility of the WTO regime as the whole.

Compared with the exceptions incorporated in GATT: XI: 2 (a), GATT: XX(b), GATT: XX(g) and GATT: XX(i), it is relatively easy to impose and increase export duties. Therefore, export duties may be abused in future by those WTO members who are not obligated to abolish or limit export duties in order to secure rare natural resources within their territories, while others who are obligated to abolish or limit export duties do not have any recourse. Ideally the GATT 1994 should be amended to include the concession approach where WTO members limit themselves to the maximum of concession rates when imposing export duties. However, an amendment of the GATT 1994 may be difficult and unrealistic. Given this situation, it is submitted that an innovative interpretation should be considered and adopted whereby WTO members who agreed to abolish export duties can be rescued from condemnation by invoking GATT: XX exceptions even if their accession protocols do not specifically state that they can invoke them. As discussed earlier, the Appellate Body stated in its report that the mere fact that a paragraph in the Accession Protocol does not mention WTO agreement should not be interpreted to mean that that member is excluded from the benefit of GATT exceptions. This statement of the Appellate Body is suggestive of such new interpretation.

6.2 The Relationship Between the WTO Agreement and WTO Accession Protocols

The rulings of the Panel and the Appellate Body in the *China Rare Earths Case* prompts consideration of the larger question of the relationship between the WTO Agreement and WTO accession protocols. In the previous section it was pointed out that the Appellate Body ruling on this issue is contradictory, illogical and internally inconsistent. What is more, the ruling is contrary to recognized principles of treaty interpretation under international law. The Panel and the Appellate Body largely ignored, in making their determination on this issue, the provisions of the Vienna Convention on the Law of Treaties (VCLT) (1969).

First, VCLT Article 30 clearly applies to this situation. Article 30 concerns “Application of Successive Treaties Relating to the Same Subject Matter.” Applied

to WTO accession, the first treaty is the WTO accession agreement. Once this is agreed, the party signing the accession agreement is eligible for membership in the WTO, which, under Article XII of the WTO Marrakech Agreement, may only be agreed by decision of the WTO Ministerial Conference. Upon being admitted to the WTO, a party then must accept the provisions of the WTO Marrakech Agreement and the Multilateral Trade Agreements, including the GATT. In this situation the earlier treaty is, therefore, the accession agreement. VCLT Article 30 provides that in this case the provisions of the earlier treaty apply "only to the extent its provisions are compatible with those of the later treaty." Thus, applied to the accession of a new member into the WTO, the provisions of the WTO Marrakech Agreement and the Multilateral Trade Agreements, including the GATT apply in full; the provisions of the accession agreement apply only to the extent they are not inconsistent with the Multilateral Trade Agreements. Thus, all provisions of the GATT, including the general exceptions of Article XX, apply *even when they are inconsistent with the provisions of the accession protocol.*

Second, VCLT Article 31 – the "General Rules of Interpretation" of treaties – clearly mandates the availability of the GATT general exceptions to concessions in an accession protocol. Article 31.3(a) requires, in the interpretation of a treaty, that "any subsequent agreement" between the parties must be "taken into account." The GATT in this case is such a subsequent agreement to the accession protocol and its provisions therefore apply by explicit mandate.

Thus, the panel and Appellate Body interpretations on the issue of the relationship between China's Accession Protocol and the GATT are not only illogical but clearly wrong under recognized principles of international law.

6.3 Export Quotas

The most important issue in respect of export quotas is the "in conjunction with" requirement in GATT: XX: (g). There must be a close relationship between export quotas and the restriction of domestic production or consumption of the natural resources in question in order for the export quotas to be justified as measures taken "in conjunction with" the domestic restriction of production and consumption. Both the Panel and the Appellate Body rejected the Chinese claim that the export quotas of China were taken in conjunction with the restriction of domestic production or consumption. As discussed earlier, the Panel described the details of Chinese domestic measures taken together with the export quotas and concluded that the Chinese measures on the whole have had the effect of securing the three items for Chinese domestic processing industries using them as raw materials for the finished products and promoting domestic production of the finished products.

The Panel concluded that these measures were industrial policy measures, that there was no evenhandedness between domestic purchasers and foreign purchasers of the three items, and there was no reasonable relationship between the export quotas and the domestic restriction of production in regard to the three items. The

Appellate Body generally accepted the rulings of the Panel except for the evenhandedness issue. The Panel report contained the language which may be taken to mean that the evenhandedness was an independent requirement separate from the "in conjunction with" requirement. Upon an appeal by China, the Appellate Body held that the Panel erred in this respect, but upheld the Panel Report on the whole because this error was not so serious as to nullify the whole effect of the Report.

What are the lessons that one can learn from the Panel and Appellate Body Reports? It is not sufficient for a WTO member invoking export quotas to establish that that member restricts the production or consumption of the natural resources in question. The member must establish that the export quotas are reasonably related to the domestic restriction of production or consumption. The Appellate Body did not enumerate the requirements needed to establish this reasonable relationship because the task of Panels and the Appellate Body is to resolve a particular dispute before them and not to propound a general theory of interpretation. However, one needs to draw some hints from the Reports of the Panel and the Appellate Body.

One important requirement is the parallelism in timing of quotas and domestic restriction. China imposed the export quotas first and then the restriction of production of the three items later. This disqualified the export quotas as measures taken in conjunction with the restriction of domestic production because, in this situation, the export quotas could not be regarded as measures to supplement the restriction of domestic production.

Secondly there should be a proper balance between the export quotas and the restriction of domestic production. To be sure, there need *not* be an absolute equality of supply to domestic and foreign purchasers, but the allocation to domestic purchasers and to foreign purchasers should not be unduly unbalanced. In the Chinese regime, the export quotas unused in the period to which they were assigned were not to be carried over to the next period but were taken away and allocated to domestic consumption. This was regarded as a sign that the export quota system in China was in essence a guarantee of supply to domestic industries using the three items and, therefore, amounted to the protection of the production of domestic industries.

The requirements suggested by the Panel and the Appellate Body in regard to the interpretation of the phrase "in conjunction with" in GATT: XX(g) are rather stringent and, when WTO members enforce export quotas of natural resources, they need to plan the scheme carefully so that there is no element which suggests that the measure is a protection of domestic industries using the natural resources in question. What is then the relationship between the teachings of the Panel and the Appellate Body and the permanent sovereignty of WTO members on natural resources that exist in their own territories? As long as natural resources are buried in underground or, if not underground, not yet exploited, their sovereignty on natural resources is absolute. However, as soon as they are put in the stream of commerce as commodities, WTO disciplines apply to them.

As touched upon earlier, under the rulings of the Panel and the Appellate Body, foreign and domestic purchasers do not have to be treated equally. However, there must be a reasonable balance between the supply to foreign and domestic

purchasers. What this balance should be is a question which must be answered on a case-by-case basis taking into account of the peculiar circumstances involved in each case. However, the following two hypothetical situations are presented as hypothetical situations where export quotas are allocated to foreign purchasers and domestic purchasers.

Scenario 1

Suppose the limit to production of natural resources is 100 units annually. The export quota is set at 100 units. In this way, foreign and domestic purchasers have equal opportunity to purchase natural resources within this limit according to the purchase prices that they can offer.

Scenario 2

Suppose the limit to production of natural resources is 100 units. Quotas are distributed to foreign and domestic purchasers according to the proportionality principle. Foreign and domestic purchasers are allocated shares on the basis of their market shares in the purchase of the natural resources that they occupied when the export quota system was initiated. If, at the time when the export quota system was initiated, the foreign purchasers A, B, and C had 50 % share and A shared 30 and B and C each shared 10, respectively, and the domestic purchasers shared 50 %, then the quotas are distributed in accordance with that proportion.

Scenario 1 is an attempt to preserve free trade as much as possible within the export quota system because, in this regime, foreign and domestic purchasers can engage in free competition in purchasing the natural resources in question. However, the risk is that, under this regime, foreign purchasers may be more efficient than domestic purchasers and, if so, they will be able to purchase all of the supply of the natural resources. In this way, the supply of the natural resources is drained from the domestic market. Perhaps, under this circumstance, a WTO member facing this problem can make use of exceptions incorporated in GATT: XI: 2: (a), GATT: XX (i) or, if the situation is really serious, GATT: XXI (national security). When examining closely the contents of the Panel and the Appellate Body Report, one can probably say that their teachings do not necessarily require WTO members to take a Scenario 1 approach. Scenario 2 is more trade restrictive compared with Scenario 1. However, export quotas are an exception to the general free trade principle, and reasonable measures to implement this exception should be allowed. In light of this, it is submitted that Scenario 2 is also permissible under GATT: XX (g). In fact, the idea of Scenario 2 is drawn from a provision with import quotas under the Safeguard Agreement.[21] In the Safeguard Agreement, WTO members are

[21] Article 5: 2 (a) of the Safeguard Agreement requires that a WTO member applying import quota as a safeguard measure must consult with other members having a substantial interest in supplying the product in question with respect to the shares of such members that will be allotted to them with a view to reaching an agreement with them. However, Article 5: 2 (a) continues that, when this method is not reasonably practicable, “the Member concerned shall allot to Members having a substantial interest in supplying the product shares based upon the proportions supplied by such Members during a previous representative period, of the total quantity or value of imports of the

allowed to set a limit to the quantity of import of a product under certain circumstances and to allocate import quotas to exporting countries in accordance with the proportion of the shares that they occupied when the import quota was initiated. This is an attempt to introduce the principle of equity in allocating quotas to exporting countries according to the accomplishment of each exporting country and reflects the relative efficiency of each exporting country at the time the import quota system was initiated.

However, a problem of Scenario 2 is that, once the quota is set to each purchaser, competition ceases to exist among purchasers at that time, and the relative efficiency of each purchaser may (and is likely to) change. In order to secure the optimum allocation of natural resources, this is not desirable. It is, therefore, necessary to set a time period for the export quota (for example, 2 years) and, when the time period ends, an auction of quotas should be held for another allocation among all interested parties.

7 Conclusions

The *China Rare Earths Case*, along with the earlier *China Minerals Export Case* are important rulings that bring to the fore three significant issues with respect to WTO law. First, the regulation of export duties under the rules of the multilateral trading system is deeply flawed. While most WTO members are allowed to impose export duties virtually at will, other WTO members are under restrictions in this regard, either because of the terms of their protocols of accession or because of (frequently inadvertent) restrictions contained in their schedules of concessions. There is no rationality in the allocation of rules concerning export duties, and this constitutes a systemic flaw in WTO law. The export duty rules as they now exist are, in fact unfair and discriminatory. Such a regime must urgently be corrected if the WTO is to survive and prosper.

Second, the rulings of the Panels and the Appellate Body with respect to the relationship between the WTO Agreement and WTO accession protocols is deeply flawed. The ruling that the relationship depends on a case-by-case determination with respect to each part of every accession agreement as to whether provisions of GATT 1994 apply is wrong and unworkable, a formalistic interpretation that cannot stand.

Third, the China Rare Earths Case clarifies the meaning of the GATT general exceptions, especially GATT Article XX(g), with respect to international trade measures that concern the conservation of natural resources. The interpretations of the elements of GATT Article XX(g) set out by the Panel and the Appellate Body

product, due account being taken of any special factors which may have affected or may be affecting the trade in the product”.

serve to clarify the rules that must be observed by WTO members that adopt genuine measures to conserve natural resources within their jurisdictions.

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Chapter 6
The World Trade Organization and Export Restrictions

Gabrielle Marceau

Abstract This chapter focuses on the disciplines on export restrictions found in the WTO agreements as well as relevant jurisprudence by WTO panels and the Appellate Body in general and in particular in the context of export restrictions on natural resources. In addition, the wider impact of export restrictions is examined in the areas of sustainable development, food security, and environmental protection. The chapter also explores alternative approaches and suggestions for increasing the regulation of export restrictions, found in accession protocols of some recently acceded WTO Members, regional trade agreements, negotiating proposals in the context of the Doha Round and G20 negotiations, and academic literature.

Keywords Export restrictions • Export duties • Export quotas • Quantitative restrictions • Justifications • Natural resources • Food security • Sustainable development

1 Introduction

The focus of this chapter is on the World Trade Organization's (WTO) disciplines on export restrictions and the wider systemic role in sustainable development, food security, and environmental protection regulation. The terms quantitative export restrictions, export duties and export taxes, and export quotas are often used interchangeably. In this regard, we first need to clarify these terms.

Opinions expressed in this article are not binding on the WTO Secretariat or WTO Members and mistakes are those of the author only. The author is especially grateful to Louise Wichmann Madsen, Petra Beslac, Dylan Geraets, and Eileen Crowley for all their work in the production of this paper.

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_6

The WTO's Trade Policy Review (TPR) papers deal with export restrictions in the section on "measures directly affecting exports". The TPRs cover export-restrictive measures, typically export prohibitions, export quotas, export licensing, export duties or export tariffs,[1] and minimum export prices. As further developed below, the WTO includes different rules for export duties and export quotas and export licenses, so the distinction is important. As noted earlier, this text will generally not use the term 'export taxes' for export border measures – rather the terms used will be 'export duties' or 'export tariffs'.

Export restrictions are imposed for a number of reasons. Sometimes they are put in place to provide support or protection to certain consumer or producer groups to gain political support. In the agricultural and food sectors, the primary objective of export restrictions is often to maintain domestic food supplies and hereby achieve food security, especially in so-called 'thin' international markets where prices are more volatile.[2]

Export restrictions can also be used to address market failures, especially in the field of environmental protection. For example, countries may restrict exportation of minerals, forest products or other natural resources to prevent or slow down resource depletion.[3] Since these restrictions constitute a form of market distortion they can affect the distribution of welfare.[4] They can also lead to trade diversion or retaliation where other countries impose their own export restrictions on products in response to the export restrictions originally imposed, which, in turn, can impede the effectiveness of the original measure in achieving the intended objective.[5]

Section 2 will set out the WTO disciplines on export restrictions in the covered agreements and focus on recent WTO jurisprudence, drawing, *inter alia*, on the decisions of the Panels and Appellate Body in two recent disputes, *China – Raw Materials* and *China – Rare Earths*. Section 3 will present commitments on export

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[1]Several authors use the term 'export taxes' to refer to what would legally be characterized as 'export duties' or 'export tariffs' since they are imposed at the border and traditionally the term 'taxes' refers to amounts paid after imported goods have passed the frontiers and their import tariff or import duties have been paid. Throughout this paper, the term 'export restrictions' include both export duties/tariffs and export quotas and other quantitative export restrictions. The term 'export taxes' will not be used unless in quoting another author or a text where such term is used.

[2]Karapinar (2011), p. 1141.

[3]Karapinar (2011), p. 1142.

[4]For a full discussion of the economic and welfare impact of these measures, see Mitra and Josling (2009).

[5]As an example of this, Korinek and Kim point to the export duty imposed by India on chromite in 2007. This export duty led to reduced exports to China, which had been the biggest importer of Indian chromite and instead diverted its chromite imports to other countries, most notably South Africa. Since South African manufacturers and downstream industries were now competing with China's downstream industries, South Africa considered imposing its own export restriction on the mineral to offset this increased competition. Korinek and Kim point out that such "retaliatory" export restrictions by South Africa would have led to a higher international price of chromite which would entail that India would have to raise its export duty further to achieve the policy objective of reducing exports of chromite (Korinek and Kim (2009), pp. 16–19).

restrictions undertaken by certain recently acceded Members in their accession protocols as well as WTO jurisprudence on the relationship between such commitments and the WTO agreements. Section 4 will address the role of export restrictions in food security, sustainable development, and environmental protection. Section 5 will examine the disciplines imposed on export restrictions in regional trade agreements (RTAs). Section 6 will introduce some proposed reforms and Sect. 7 will offer some conclusions.

2 WTO Law on Export Restrictions on Natural Resources: Legal Provisions and Jurisprudence

The WTO agreements include a number of provisions dealing with export restrictions, either by disciplining the use of such restrictions or by justifying their use, in spite of the disciplines. WTO panels and the Appellate Body have interpreted and applied these provisions in the context of export restrictions on natural resources. Below, the relevant provisions and jurisprudence are examined.

2.1 Legal Provisions in the WTO Agreements

The WTO disciplines on export quotas and other quantitative restrictions are contained in Article XI of the General Agreement on Tariffs and Trade (GATT 1994) and Article 12 of the Agreement on Agriculture (AoA).

2.1.1 Quantitative Export Restrictions

Article XI of the GATT 1994

The key WTO disciplines on export restrictions are contained in Article XI of the GATT 1994, which is titled "General Elimination of Quantitative Restrictions". Paragraph 1 of Article XI stipulates a general prohibition on quantitative export (and import) restrictions:

> No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses 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.[6]

[6]For full text and interpretative notes, see WTO website, https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art11_e.pdf

Paragraph 2 of Article XI provides some limited exceptions or deviations to this general prohibition on quantitative export (and import) restrictions. It states in relevant parts:

> The provisions of paragraph 1 of this Article shall not extend to the following:
>
> (a) Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party;
> (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[7];

Article 12 of the Agreement on Agriculture

The AoA elaborates on the matter of disciplines on export prohibitions and restrictions applied on agricultural products. Article 12 stipulates that when a Member institutes new export restrictions on foodstuffs in accordance with subparagraph 2 (a) of Article XI of the GATT 1994:

> (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;
> (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 comprising such information as the nature and the duration of such measure, 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. The Member instituting such export prohibition or restriction shall provide, upon request, such a Member with necessary information.[8]

2.1.2 Export Duties/Tariffs

Article XI of the GATT 1994 prohibits export quotas and other quantitative restrictions, but exempts from its coverage export restrictions in the form of "duties, taxes, or other charges". In principle, then, export duties or export tariffs are permitted under WTO law and their level is not regulated unless a Member schedules commitments on export duties.[9] Some Members that acceded to the WTO in or after 1996 have accepted limitations on their right to impose export duties in their accession protocols. The precise nature and scope of these limitations

[7]For full text and interpretative notes, see WTO website, https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art11_e.pdf

[8]For full text and interpretative notes, see WTO website, https://www.wto.org/english/res_e/booksp_e/analytic_index_e/agriculture_02_e.htm#article12

[9]The Appellate Body confirmed this interpretation in *China – Raw Materials*. (Appellate Body Report, *China – Raw Materials*, para. 321).

vary between Members and are described in more detail in Sect. 3 below. Finally, most experts believe that export measures such as export duties are nonetheless covered by relevant rules of the GATT legal system and that export duties should, for example, respect the Most Favoured Nation (MFN) principle of Article I, the prescriptions of Article XXIV:8(a)(ii), and could thus benefit from the flexibilities in Article XX for justifying GATT violations.

2.1.3 Exceptions in Article XX of the GATT 1994

Article XX of the GATT 1994 contains exceptions that may enable a WTO Member to deviate from GATT Article XI:1's prohibition against quantitative export restrictions, allowing it to restrict exports in certain circumstances. Export restricting measures that may be covered by Article XX include those:

(b) necessary to protect human, animal or plant life or health;
(c) relating to the importations or exportations of gold or silver;
. . .
(f) imposed for the protection of national treasures of artistic, historic or archaeological value;
(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;
. . .
(i) involving restrictions on exports of domestic materials necessary to ensure essential qualities of such 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 governmental stabilization plan; *Provided* that such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry, and shall not depart from the provisions of this Agreement relating to non-discrimination.
(j) essential to the acquisition or distribution of products in general or local short supply; *Provided* that any such measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of the Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist.[10,11]

It is worth noting that Article XX may also be invoked to justify the imposition of export duties, when such duties are a priori WTO inconsistent for the reasons outlined above or when such duties are inconsistent with stricter disciplines on

[10]This chapter will not address the GATT Article XXI security exception. As acknowledged by the Appellate Body in *Argentina – Import Measures*, "certain provisions of the GATT 1994, such as Articles XII, XIV, XV, XVIII, XX, and XXI permit a Member, in certain specified circumstances, to be excused from its obligations under Article XI:1 of the GATT 1994." (Appellate Body Report, *Argentina – Import Measures*, para. 5.220). (footnote omitted) See also Appellate Body Report, *Argentina – Textiles and Apparel*, para. 73.

[11]For full text and interpretative notes, see WTO website, https://www.wto.org/English/res_e/booksp_e/gatt_ai_e/art20_e.pdf

export duties undertaken by a particular Member. The precise nature and applicability of these exceptions, however, vary between accession protocols and are described in more detail below.

The Agreement on Technical Barriers to Trade (TBT Agreement) allows regulatory measures that impose restrictions in the form of a technical regulation. Furthermore, Article III of the GATT 1994 allows for border collection or enforcement of internal taxation or regulation that otherwise respect the National Treatment principle contained in this provision.[12] However these provisions do not seem to apply to export measures.

2.2 WTO Jurisprudence Relating to Export Restrictions on Natural Resources

The WTO has not been asked to adjudicate many disputes concerning export restrictions. Nevertheless, the few cases that have been brought have provided panels and the Appellate Body with opportunities to clarify some important principles.

2.2.1 Article XI of the GATT 1994

Article XI:1: Meaning of "Prohibition" and "Restriction"

Recall that Article XI:1 of the GATT 1994 prohibits "prohibitions or restrictions" on exports (and imports). What is the meaning of the terms "prohibition" or "restriction"? In *China – Raw Materials*, the Appellate Body explained that:

> The term "prohibition" is defined as a "legal ban on the trade or importation of a specified commodity". The second component of the phrase "[e]xport prohibitions or restrictions" is the noun "restriction", which is defined as "[a] thing which restricts someone or something, a limitation on action, a limiting condition or regulation", and thus refers generally *to something that has a limiting effect*.
>
> In addition, we note that Article XI of the GATT 1994 is entitled "General Elimination of *Quantitative* Restrictions" ... In the present case, we consider that the use of the word "quantitative" in the title of the provision informs the interpretation of the words "restriction" and "prohibition" in Article XI:1 and XI:2. It suggests that Article XI of the GATT 1994 covers *those prohibitions and restrictions that have a limiting effect on the quantity or amount of a product being imported or exported.*[13]

[12] According to the Ad Note to Article III of the GATT 1994, international taxation or regulation which is applied to an imported product and to the like domestic product thus fall within the scope of Article III regardless of whether it is collected or enforced at the time or point of importation.

[13] Appellate Body Report, *China – Raw Materials*, paras. 319–320. (emphasis added; footnote omitted)

In *Argentina – Import Measures*, the Appellate Body found that:

> Article XI:1 refers to prohibitions or restrictions "on the importation ... or on the exportation or sale for export". Thus, in our view, not every condition or burden placed on importation or exportation will be inconsistent with Article XI, but only those that are limiting, that is, those that limit the importation or exportation of products. Moreover, this limitation need not be demonstrated by quantifying the effects of the measure at issue; rather, such limiting effects can be demonstrated through the design, architecture, and revealing structure of the measure at issue considered in its relevant context.[14]

Article XI:2(a): Meaning of "Temporarily", "Applied to Prevent or Relieve" and "Critical Shortages"

As noted earlier, Article XI:2(a) of the GATT 1994 allows export restrictions to be "temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting country". No definitions exist as to what is "temporarily", "critical" or what constitutes a "shortage". In *China – Raw Materials*, the Appellate Body clarified the meaning of the term "temporarily" in Article XI:2(a) of the GATT as follows:

> [T]he term "temporarily" in Article XI:2(a) of the GATT 1994 is employed as an adverb to qualify the term "applied". The word "temporary" is defined as "[l]asting or meant to last for a limited time only; not permanent; made or arranged to supply a passing need". Thus, when employed in connection with the word "applied", it describes a measure applied for a limited time, a measure taken to bridge a "passing need". As we see it, the definitional element of "supply[ing] a passing need" suggests that *Article XI:2(a) refers to measures that are applied in the interim.*[15]

The Appellate Body also clarified that a measure may be characterized as "temporarily applied" even if its duration is not definitively known in advance. Thus, the Appellate Body found that "temporary" need not always "connote a time-limit fixed in advance. Instead, we consider that Article XI:2(a) describes measures applied for a limited duration, which was adopted in order to bridge a passing need, irrespective of whether or not the temporal scope of the measure is fixed in advance."[16]

According to the Appellate Body, the term "applied to prevent or relieve" indicates that measures may be adopted under Article XI:2(a) "to alleviate or reduce an existing critical shortage, as well as for preventive or anticipatory measures adopted to pre-empt an imminent critical shortage".[17] In this context, recall the Appellate Body's finding, discussed above, which stipulates that a measure may be adopted under Article XI:2(a) even if its temporal scope is not known in advance. This allows Members to respond to a critical shortage even if

[14] Appellate Body Report, *Argentina – Import Measures*, para. 5.217. (footnote omitted)

[15] Appellate Body Report, *China – Raw Materials*, para. 323. (emphasis added; footnote omitted)

[16] Appellate Body Report, *China – Raw Materials*, para. 331.

[17] Appellate Body Report, *China – Raw Materials*, para. 327.

they do not precisely know how long it will be before the critical shortage is alleviated or prevented.

According to the Appellate Body, a "critical shortage" "refers to those deficiencies in quantity that are crucial, that amount to a situation of decisive importance, or that reach a vitally important or decisive stage, or a turning point."[18]

The Appellate Body further explained that "whether a shortage is 'critical' may be informed by how 'essential' a particular product is."[19] The Appellate Body did not provide an exhaustive definition of the term "essential". Rather, it pointed out that "[t]he term 'essential' is defined as '[a]bsolutely indispensable or necessary'."[20] On the basis of this definition, it held that "Article XI:2(a) refers to critical shortages of foodstuffs or otherwise absolutely indispensable or necessary products. By including, in particular, the word 'foodstuffs', Article XI:2(a) provides a measure of what might be considered a product 'essential to the exporting Member' but it does not limit the scope of other essential products only to foodstuffs."[21]

2.2.2 Export Duties/Tariffs

Export duties have not often been challenged in WTO disputes but the administration of such export duties was challenged in one dispute, namely Argentina – Hides and Leather. The European Communities (EC) challenged the authorization granted by the Argentinean authorities to the domestic tanning industry to participate in customs control procedures of hides as being inconsistent with Articles XI:1 and X:3(a) of the GATT 1994. The latter requires Members to administer their trade regulations in a uniform, impartial, and reasonable manner.[22] While Argentina's export duties were not brought up in the context of the EC's challenge under Article XI:1, the Panel did find that the authorization to involve private persons to assist customs officials in the application and enforcement of substantive rules, namely the rules on classification and export duties, was an unreasonable and partial administration of such substantive rules and thus inconsistent with Article X:3 (a).[23] It is thus clear that export duties are subject to, at least, some of the disciplines in the GATT 1994, here Article X:3(a) regarding the administration of export duties.

[18] Appellate Body Report, *China – Raw Materials*, para. 324.

[19] Appellate Body Report, *China – Raw Materials*, para. 328.

[20] Appellate Body Report, *China – Raw Materials*, para. 326. (footnote omitted)

[21] Appellate Body Report, *China – Raw Materials*, para. 326.

[22] For full text and interpretative notes, see WTO website, https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art10_e.pdf

[23] Panel Report, *Argentina – Hides and Leather*, paras. 11.91–11.101.

2.2.3 Exceptions in Article XX of the GATT 1994 Relating to Natural Resources

Panels and the Appellate Body have also clarified the scope, meaning, and applicability of the exceptions in Article XX of the GATT 1994 as a justification for otherwise WTO-inconsistent export restrictions (or other inconsistencies with any of the GATT obligations). If a measure is to be justified under Article XX, the regulating Member must demonstrate (i) that the measure falls within one or more of the paragraphs of Article XX; and (ii) that the measure is applied consistently with the provisions of the chapeau. Of the paragraphs noted above, only Article XX(g) and (b) have been the subject of WTO dispute settlement reports regarding export restrictions. This author will therefore concentrate on the requirements of these provisions.

Article XX(b) of the GATT 1994

Article XX(b) of the GATT 1994 allows Members to adopt measures "necessary to protect human, animal or plant life or health". Panels and the Appellate Body have often followed two analytical steps when considering whether a measure falls within the exception in Article XX(b) of the GATT 1994: (i) whether the objective of the measure is to protect human, animal or plant life or health; and (ii) whether the measure is "necessary" to fulfil this policy objective. These two steps are considered separately below.

Article XX(b): Objective of the Measure

Under the first step, when considering whether a measure's objective is the protection of human, animal or plant life or health, panels and the Appellate Body have examined both the design and structure of the measure, and have generally showed a degree of deference to Members' policies.[24] The degree of deference is, however, not unlimited. The Panel in *China – Raw Materials* thus found that a Member seeking to justify a measure under Article XX(b) "must do more than simply produce a list of measures referring, *inter alia*, to environmental protection and polluting products".[25] Rather, the Member must demonstrate a connection between environmental protection standards and the measure it seeks to justify.[26]

Article XX(b): "Necessary"

Under the second step of the analysis to be conducted under Article XX(b) of the GATT 1994, panels must first consider the relevant factors, in particular (i) the

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[24]Panel Report, *China – Raw Materials*, para. 7.479.

[25]Panel Report, *China – Raw Materials*, para. 7.511.

[26]Panel Report, *China – Raw Materials*, para. 7.507. See also Panel Report, *China – Rare Earths*, paras. 7.159–7.160.

importance of the interests or values at stake; (ii) the extent of the measure's contribution to the achievement of the listed objective; and (iii) the measure's trade restrictiveness.[27]

Importantly, the Appellate Body has recognized that "certain complex public health or environmental problems may be tackled only with a comprehensive policy comprising a multiplicity of interacting measures",[28] which prompted the Panel in *China – Rare Earths* to state that "[w]ith respect to such complex problems, the Appellate Body has left open the possibility that a 'necessary' measure could contribute to one of the objectives protected under Article XX(b) as part of a policy framework comprising different measures, resulting in possible synergies between those measures."[29]

Furthermore, the Appellate Body has found that a measure cannot only be considered necessary if it is shown to "bring[] about a material contribution to the achievement of its objective" but also if it is demonstrated to be "apt to produce a material contribution to the achievement of its objective".[30] In respect of the latter, the Appellate Body found that such a demonstration could consist of "quantitative projections in the future, or qualitative reasoning based on a set of hypotheses that are tested and supported by sufficient evidence",[31] interpreted by the Panel in *China – Raw Materials* as suggesting that the contribution of a measure should be assessed both currently and in the future.[32]

In the context of export restrictions, the Panel in *China – Rare Earths* accepted that the objective of reducing pollution could be achieved indirectly by reducing demand of a product through increasing prices.[33] The Panels in both *China – Raw Materials* and *China – Rare Earths*, however, placed the burden on the Member imposing the measure to account for the increased domestic consumption of the good subject to the export restriction that may be generated through additional production in the domestic downstream sectors following the imposition of the export restriction,[34] which, in the words of the Panel in *China – Raw Materials*, may "offset the production-reducing effects of export restrictions ... and, consequently, their alleged positive effects on the environment".[35] In addition, the Panel in *China – Raw Materials* rejected the argument that export restrictions on certain

[27] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 178 (referring to Appellate Body Report, *US – Gambling*, para. 307).

[28] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 151.

[29] Panel Report, *China – Rare Earths*, para. 7.146. (footnote omitted)

[30] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 151.

[31] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 151.

[32] Panel Report, *China – Raw Materials*, para. 7.518.

[33] Panel Report, *China – Rare Earths*, para. 7.173.

[34] Panel Reports, *China – Raw Materials*, para. 7.536; and *China – Rare Earths*, paras. 7.174–7.178.

[35] Panel Report, *China – Raw Materials*, para. 7.536.

raw materials would necessarily foster economic growth which would, in turn, lead to increased environmental protection.[36]

If a measure is preliminarily deemed necessary for achieving one of the objectives listed in Article XX(b), panels must next compare that measure with alternative measures identified by the complainant that would be technically and financially available for the respondent.[37] Such alternative measures must be less trade restrictive while providing an equivalent contribution to the achievement of the listed objective and must not impose an undue burden on the Members imposing the measure.[38] While the burden of proof initially lies upon the complainant to identify possible alternatives, the burden then shifts to the respondent to demonstrate that the proposed alternative is not a genuine alternative or is not reasonable available.[39]

Article XX(g) of the GATT 1994

As noted above, Article XX(g) allows Members to adopt measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption". The Appellate Body in *China – Rare Earths* emphasized that Article XX(g) presents a "holistic" test, such that a Member wishing to justify a measure by reference to the provision "must show that it satisfies all the requirements set out in that provision".[40] Nevertheless, panels and the Appellate Body have often divided their analysis into two sections, looking first at whether the measure "relates to the conservation of exhaustible natural resources", and second at whether the measure is "made effective in conjunction with restrictions on domestic production or consumption". For ease of presentation, our review of the jurisprudence similarly looks at these two "limbs" of Article XX(g) separately.

Article XX(g): "Relating to the Conservation of Exhaustible Natural Resources"

In *China – Rare Earths*, the Appellate Body reaffirmed existing jurisprudence (specifically, its decision in *China – Raw Materials*) on the meaning of this term. It thus held, once again, that:

> [F]or a measure to "relate to" conservation in the sense of Article XX(g), there must be "a close and genuine relationship of ends and means" between that measure and the

[36] Panel Report, *China – Raw Materials*, paras. 7.544–7.550 and 7.553–7.554.

[37] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 156.

[38] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 156 (referring to Appellate Body Report, *US – Gambling*, paras. 308 and 311).

[39] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 156 (referring to Appellate Body Report, *US – Gambling*, para. 311).

[40] Appellate Body Report, *China – Rare Earths*, para. 5.94.

> conservation objective of the Member maintaining the measure. Hence, a GATT-inconsistent measure that is merely incidentally or inadvertently aimed at a conservation objective would not satisfy the "relating to" requirement of Article XX(g).[41]

The Appellate Body also stated that the question of whether a measure "relates to" conservation may be answered by looking primarily at its "design and structure".[42] However, "panels are not precluded from considering evidence relating to the actual operation or the impact of the measure at issue in an assessment under subparagraph (g)."[43]

In accordance with the principle that Article XX(g) imposes a "holistic" test, the Appellate Body explained that "the absence of a domestic restriction, or the way in which a challenged measure applies to domestic production or consumption, may be relevant to an assessment of whether the challenged measure 'relates to' conservation."[44]

According to the Appellate Body in *China – Rare Earths*:

> [F]or the purposes of Article XX(g), the precise contours of the word "conservation" can only be fully understood in the context of the exhaustible natural resource at issue in a given dispute. For example, "conservation" in the context of an exhaustible mineral resource may entail preservation through a reduction in the pace of its extraction, or by stopping its extraction altogether. In respect of the "conservation" of a living natural resource, such as a species facing the threat of extinction, the word may encompass not only limiting or halting the activities creating the danger of extinction, but also facilitating the replenishment of that endangered species.[45]

The Appellate Body in *China – Rare Earths* confirmed that the meaning of the term "exhaustible natural resources" is not static or fixed. Rather, it is "by definition, evolutionary".[46] Accordingly, it may encompass both non-living (e.g. minerals, clean air) and living (e.g. turtles) resources.

Article XX(g): "Made Effective in Conjunction with Restrictions on Domestic Production or Consumption"

In *China – Raw Materials*, the Appellate Body explained that the terms "made effective" and "in conjunction with" require that trade-disruptive conservation-related measures "work together" with limitations on domestic production or consumption.[47] However, the Appellate Body was also careful to emphasize that "Article XX(g) does not contain an additional requirement that the conservation measure be primarily aimed at making effective the restrictions on domestic

[41] Appellate Body Report, *China – Rare Earths*, para. 5.90. (footnotes omitted)
[42] Appellate Body Report, *China – Rare Earths*, paras. 5.111–5.112.
[43] Appellate Body Report, *China – Rare Earths*, para. 5.114.
[44] Appellate Body Report, *China – Rare Earths*, para. 5.90. (footnote omitted)
[45] Appellate Body Report, *China – Rare Earths*, para. 5.89. (footnote omitted)
[46] Appellate Body Report, *China – Rare Earths*, para. 5.89.
[47] Appellate Body Report, *China – Raw Materials*, para. 356.

production or consumption."[48] In other words, while the trade-disruptive and domestic measures are expected to "work together" for the purposes of conservation, there is no requirement that the trade-disruptive measure itself function only or primarily to enforce a domestic restriction.

The Appellate Body developed this interpretation further in *China – Rare Earths*. In that case, it stated:

> Taking both of these elements ["made effective" and "in conjunction with"] together, the second clause of Article XX(g) refers to governmental measures that are promulgated or brought into effect, and that operate together with restrictions on domestic production or consumption of exhaustible natural resources. Thus, the requirement that restrictions be made effective "in conjunction" suggests that, in their joint operation towards a conservation objective, such restrictions limit not only international trade, but must also limit domestic production or consumption. Moreover, in order to comply with the "made effective" element of the second clause of Article XX(g), it would not be sufficient for domestic production or consumption to be subject to a possible limitation at some undefined point in the future. Rather, a Member must impose a "real" restriction on domestic production or consumption that reinforces and complements the restriction on international trade.[49]

Recall the definition of "restriction" provided by the Appellate Body in *China – Raw Materials* and *Argentina – Import Measures* in the context of interpreting Article XI:1 of the GATT 1994 (discussed above). In *China – Rare Earths*, the Appellate Body made it clear that "restriction" has the same meaning in Article XX (g) as it does in Article XI:1. Thus, for the purposes of Article XX(g), a "restriction" is "[a] thing which restricts someone or something, a limitation on action, a limiting condition or regulation."[50]

According to the Appellate Body in *China – Rare Earths*, the "second limb" of Article XX(g) requires that "a Member seeking to rely upon Article XX(g) in its pursuit of a conservation objective must demonstrate that it imposes restrictions, not only in respect of international trade, but also in respect of domestic production or consumption."[51] According to the Appellate Body, "[s]uch restrictions must place effective limitations on domestic production or consumption and thus operate so as to reinforce and complement the restrictions imposed on international trade."[52] Thus, in the Appellate Body's view, the second "limb" of Article XX(g) "is a requirement of *even-handedness* in the imposition of restrictions, in the pursuit of conservation, upon the production or consumption of exhaustible natural resources."[53]

Note, however, that the Appellate Body made it clear that the notion of "even-handedness" does not impose an *additional* or *separate* test. It explained that:

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[48] Appellate Body Report, *China – Raw Materials*, para. 356.

[49] Appellate Body Report, *China – Rare Earths*, para. 5.92.

[50] Appellate Body Report, *China – Rare Earths*, para. 5.91. (footnote omitted)

[51] Appellate Body Report, *China – Rare Earths*, para. 5.93.

[52] Appellate Body Report, *China – Rare Earths*, para. 5.93.

[53] Appellate Body Report, *China – Rare Earths*, para. 5.93. (emphasis original; footnote omitted)

> [W]e do not see the notion of "even-handedness" as imposing a separate requirement that must be fulfilled in addition to the condition that a measure be "made effective in conjunction with restrictions on domestic production or consumption". Rather . . . the terms of Article XX(g) themselves reflect the notion of even-handedness in the imposition of restrictions.[54]

Thus, according to the Appellate Body, the notion of "even-handedness":

> [D]oes not suggest that Article XX(g) contains a requirement that the burden of conservation be evenly distributed, for instance, in the case of export quotas, between foreign consumers, on the one hand, and domestic producers or consumers, on the other hand. Having said that, we note that it would be difficult to conceive of a measure that would impose a significantly more onerous burden on foreign consumers or producers and that could still be shown to satisfy all of the requirements of Article XX(g).[55]

2.2.4 Difference Between Export Restrictions Covered by GATT Article XI:2(a) and Those Justified Under GATT Article XX

Measures that fall within Article XI:2(a) do not constitute violations of the GATT 1994. Accordingly, they do not need to be justified under the provisions of GATT Article XX.[56] An export restriction may be defended on the basis that it *either* meets the criteria in Article XI:2(a) *or* that it is justified by one or more of the paragraphs of Article XX. Of course, if a Member seeks to defend an export restriction under one of the paragraphs of Article XX, the export restriction must also meet the requirements of the chapeau of Article XX, which requires that measures "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".

Indeed, in *China – Raw Materials*, the Appellate Body was careful to note that the reach of Article XI:2(a) is not the same as that of Article XX(g):

> Articles XI:2(a) and Article XX(g) have different functions and contain different obligations. Article XI:2(a) addresses measures taken to prevent or relieve "critical shortages" of foodstuffs or other essential products. Article XX(g), on the other hand, addresses measures relating to the conservation of exhaustible natural resources.[57]

The Appellate Body thus accepted the Panel's conclusion that the two provisions are "intended to address different situations and thus must mean different things".[58] It is important to be aware that although measures taken pursuant to Article XI:2

[54] Appellate Body Report, *China – Rare Earths*, para. 5.127.

[55] Appellate Body Report, *China – Rare Earths*, para. 5.134.

[56] This interpretation was confirmed by the Appellate Body in *China – Raw Materials*. (Appellate Body Report, *China – Raw Materials*, para. 334).

[57] Appellate Body Report, *China – Raw Materials*, para. 337.

[58] Appellate Body Report, *China – Raw Materials*, para. 337. (footnote omitted)

(a) are, as the Appellate Body stated in *China – Raw Materials*, beyond the "scope for the application of Article XX",[59] "a measure falling within the ambit of Article XI:2(a) could relate to the same product as a measure relating to the conservation of an exhaustible natural resource."[60] Thus, a measure taken to prevent or relieve a critical shortage may overlap with a measure relating to exhaustible natural resources. The Appellate Body explained that:

> It would seem that Article XI:2(a) measures could be imposed, for example, if a natural disaster caused a "critical shortage" of an exhaustible natural resource, which, at the same time, constituted a foodstuff or other essential product. Moreover, because the reach of Article XI:2(a) is different from that of Article XX(g), an Article XI:2(a) measure might operate simultaneously with a conservation measure complying with the requirements of Article XX(g).[61]

3 Disciplines and Jurisprudence on Export Duties in Accession Protocols

In addition to the disciplines contained in the WTO agreements, some recently acceded Members have taken on further commitments with respect to export restrictions. The Panel in *China – Raw Materials*, in a finding not appealed by any party to the dispute, explained that the terms of China's Accession Protocol are integral parts of the WTO Agreement and are enforceable in dispute settlement proceedings.[62] There is no reason why this conclusion would not apply generally to other Members' accession protocols. This section will therefore proceed to examine the special and additional commitments on export restrictions included in some accession protocols. As explained above, the GATT 1994 does not include any prohibition on the use of export duties (parallel to the general prohibition on the use of export quotas and other quantitative export restrictions) or any disciplines on the level or on the scheduling of export duties. While many Members have also undertaken commitments with respect to quantitative export restrictions, most

[59] Appellate Body Report, *China – Raw Materials*, para. 334.

[60] Appellate Body Report, *China – Raw Materials*, para. 337.

[61] Appellate Body Report, *China – Raw Materials*, para. 337. (footnote omitted)

[62] The Panel in *China – Raw Materials* thus stated that "[t]he second sentence of Paragraph 1.2 of China's Accession Protocol states that provisions of the Protocol are 'an integral part of the WTO Agreement'. Thus, the provisions of the Accession Protocol are enforceable in WTO dispute settlement proceedings pursuant to Article 1.1 of the DSU. This is consistent with the approach taken by panels and the Appellate Body." (Panel Report, *China – Raw Materials*, para. 7.64 (referring to Panel and Appellate Body reports, *China – Auto Parts*; and *China – Publications and Audiovisual Products*)).

often reiterating or clarifying the existing provisions in the WTO agreements,[63] this section therefore focuses solely on commitments undertaken with respect to export duties. In total, 16 Members have made commitments on export duties in their accession protocols.[64]

Bulgaria agreed that, after its accession, it would "minimize its use of such [export] taxes"[65] and that export taxes "would be applied in accordance with the provisions of the WTO Agreement".[66]

Mongolia made a commitment to transform its export prohibition on raw cashmere into an *ad valorem* export duty of maximum 30 % which would be phased out and eliminated within 10 years of Mongolia's accession.[67] Mongolia, however, later applied for and received a temporary waiver, allowing it five additional years to phase out the export duty, in order to protect its domestic cashmere industry.[68]

Latvia undertook to abolish all existing export duties with the exception of the duty on exports of antiques.[69]

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[63]See, e.g. WTO, Report of the Working Party on the Accession of the Republic of Seychelles to the World Trade Organization, WT/ACC/SYC/64, 5 November 2014, para. 240, which requires the Seychelles to "apply its laws and regulations governing export measures, including prohibitions, export licensing requirements and other export control requirements, in conformity with WTO provisions including those contained in Articles XI, XVII, XX and XXI of the GATT 1994".

[64]Bulgaria, Mongolia, Latvia, Estonia, Georgia, Croatia, China, Saudi Arabia, Viet Nam, Ukraine, Montenegro, Russia, Lao People's Democratic Republic, Tajikistan, Kazakhstan, and Afghanistan. It should be noted that while Afghanistan's membership terms were adopted at the WTO's Tenth Ministerial Conference on 17 December 2015, they have yet to be ratified domestically by Afghanistan, by 30 June 2016, and Afghanistan does not become a Member until 30 days after it has deposited its instrument of accession. The commitments on export restrictions contained in Afghanistan's Accession Protocol are nonetheless included in this section for the sake of completeness.

[65]WTO, Report of the Working Party on the Accession of Bulgaria to the World Trade ORganization, WT/ACC/BGR/5, 20 September 1996, para. 39. Paragraph 2 of Bulgaria's Accession Protocol incorporates the paragraphs referred to in paragraph 92 of the Working Party Report, including paragraph 39. (WTO, Protocol for the Accession of Bulgaria to the World Trade Organization, WT/ACC/BGR/7, 11 October 1996, para. 2).

[66]WTO, Report of the Working Party on the Accession of Bulgaria to the World Trade Organization, WT/ACC/BGR/5, 20 September 1996, para. 39.

[67]WTO, Report of the Working Party on the Accession of Mongolia to the World Trade Organization, WT/ACC/MNG/9, 27 June 1996, para. 24. Paragraph 2 of Mongolia's Accession Protocol incorporates the paragraphs referred to in paragraph 61 of the Working Party Report, including paragraph 24. (WTO, Protocol for the Accession of Mongolia to the World Trade Organization, WT/ACC//MNG/11, 25 July 1996, para. 2).

[68]WTO, General Council Decision of 27 July 2007, WT/L/695, 1 August 2007. See also Crosby (2008).

[69]WTO, Report of the Working Party on the Accession of Latvia to the World Trade Organization, WT/ACC/LVA/32, 30 September 1998, para. 69. The export duties listed in Annex 3 were confirmed by the representative of Latvia to be the only export duties applied. Paragraph 2 of Latvia's Accession Protocol incorporates the paragraphs referred to in paragraph 131 of the Working Party Report, including paragraph 69. (WTO, Protocol for the Accession of Latvia to the World Trade Organization, WT/ACC/LVA/35, 23 October 1998, para. 2).

Like Bulgaria, Estonia agreed to "minimize the use of export taxes", and that "any such taxes applied would be in accordance with the provisions of the WTO Agreement".[70] Georgia's accession commitments are similar to those undertaken by Bulgaria and Estonia.[71]

Croatia made a commitment to "apply export duties only in accordance with the provisions of the WTO Agreement".[72]

According to China's Accession Protocol, "China shall eliminate all taxes and charges applied to exports unless specifically provided for in Annex 6 of this Protocol or applied in conformity with the provisions of Article VIII of the GATT 1994."[73] This commitment was the most far-reaching at the time of China's accession and has been the subject of dispute settlement proceedings. The Appellate Body in *China – Raw Materials* found that China had restricted its regulatory autonomy to impose export duties, except with respect to the products listed in Annex 6, and was not permitted to justify such export duties under the general exceptions in Article XX of the GATT 1994 in the absence of a cross-reference incorporating this provision or a general cross-reference to the WTO Agreement.[74]

Saudi Arabia committed "not [to] impose export duties on iron and steel scrap".[75]

Viet Nam undertook an obligation to apply "export duties, export fees and charges, as well as internal regulations and taxes applied on or in connection with

[70]WTO, Report of the Working Party on the Accession of Estonia to the World Trade Organization, WT/ACC/EST/28, 9 April 1999, para. 80. Paragraph 2 of Estonia's Accession Protocol incorporates the paragraphs referred to in paragraph 141 of Estonia's Working Party Report, including paragraph 80. (WTO, Protocol on the Accession of Estonia to the World Trade Organization, WT/ACC/EST/30, 5 July 1999, para. 2).

[71]WTO, Report of the Working Party on the Accession of Georgia to the World Trade Organization, WT/ACC/GEO/31, 31 August 1999, para 82. Paragraph 2 of Georgia's Accession Protocol incorporates the paragraphs referred to in paragraph 180 of Georgia's Working Party Report, including paragraph 82. (WTO, Protocol on the Accession of Georgia to the World Trade Organization, WT/ACC/GEO/33, 28 October 1999, para. 2).

[72]WTO, Report of the Working Party on the Accession of Croatia to the World Trade Organization, WT/ACC/HRV/59, 29 June 2000, para 101. Paragraph 2 of Croatia's Accession Protocol incorporates the paragraphs referred to in paragraph 225 of Croatia's Working Party Report, including paragraph 101. (WTO, Protocol on the Accession of Croatia to the World Trade Organization, WT/ACC/HRV/61, 19 September 2000, para. 2).

[73]WTO, Protocol on the Accession of the People's Republic of China to the World Trade Organization, WT/L/432, 23 November 2001, para. 11.3.

[74]Appellate Body Report, *China – Raw Materials*, paras. 303–307 (referring to Appellate Body Report, *China – Publications and Audiovisual Products*, paras. 215, 221, and 226).

[75]WTO, Report of the Working Party on the Accession of the Kingdom of Saudi Arabia to the World Trade Organization, WT/ACC/SAU/61, 1 November 2005, para. 184. Paragraph 2 of Saudi Arabia's Accession Protocol incorporates the paragraphs referred to in paragraph 315 of Saudi Arabia's Working Party Report, including paragraph 184. (WTO, Protocol on the Accession of the Kingdom of Saudi Arabia to the World Trade Organization, WT/L/627, 11 November 2005, para. 2).

exportation in conformity with the GATT 1994".[76] With regard to export duties on ferrous and non-ferrous scrap, Viet Nam confirmed that it "would reduce export duties in accordance with Table 17".[77]

Ukraine committed to reduce its existing export duties in accordance with Table 20(b) of its Working Party Report, and agreed not to "apply other measures having an equivalent effect, unless justified under the exceptions of the GATT 1994".[78] The Working Party Report includes a statement that "[t]he Working Party agreed that these commitments do not constitute a reinterpretation of GATT 1994, nor affect the rights and obligations of other members in respect of provisions on the application of export duties, that are measures in accordance with GATT 1994."[79]

The commitment undertaken by Montenegro regarding export duties is the most extensive commitment undertaken by an acceding Member, namely that Montenegro "would not apply or reintroduce any export duty".[80] There is no reference to the WTO Agreement or to the GATT 1994.

Part V of the Russia's Goods Schedule, which contains a list of more than 700 products, stipulates that:

> The Russian Federation undertakes not to increase export duties, or to reduce or to eliminate them, in accordance with the following schedule, and not to reintroduce or increase them beyond the levels indicated in this schedule, except in accordance with the provisions with GATT 1994.[81]

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[76]WTO, Report of the Working Party on the Accession of Viet Nam to the World Trade Organization, WT/ACC/VNM/48, 27 October 2006, para. 260. Paragraph 2 of Viet Nam's Accession Protocol incorporates the paragraphs referred to in paragraph 527 of Viet Nam's Working Party Report, including paragraph 260. (WTO, Protocol on the Accession of Viet Nam to the World Trade Organization, WT/L/662, 15 November 2006, para. 2).

[77]WTO, Report of the Working Party on the Accession of Viet Nam to the World Trade Organization, WT/ACC/VNM/48, 27 October 2006, para. 260.

[78]WTO, Report of the Working Party on the Accession of Ukraine to the World Trade Organization, WT/ACC/UKR/152, 25 January 2008, para. 240. Paragraph 2 of Ukraine's Accession Protocol incorporates the paragraphs referred to in paragraph 512 of Ukraine's Working Party Report, including paragraph 240. (WTO, Protocol on the Accession of Ukraine to the World Trade Organization, WT/L/718, 13 February 2008, para. 2).

[79]WTO, Report of the Working Party on the Accession of Ukraine to the World Trade Organization, WT/ACC/UKR/152, 25 January 2008, para. 240.

[80]WTO, Report of the Working Party on the Accession of Montenegro to the World Trade Organization, WT/ACC/CGR/38, 5 December 2011, para. 132. Paragraph 2 of Montenegro's Accession Protocol incorporates the paragraphs referred to in paragraph 281 of Montenegro's Working Party Report, including paragraph 132. (WTO, Protocol on the Accession of Montenegro to the World Trade Organization, WT/L/841, 17 December 2011, para. 2).

[81]WTO, Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization, Schedule CLXV, WT/ACC/RUS/70/Add.1, 17 November 2011, Part V. Furthermore, Russia undertook to "administer export tariff rate quotas (TRQs) in a manner that is consistent with the WTO Agreement and in particular the GATT 1994 and the WTO Agreement on Import Licensing Procedures." (WTO, Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization, WT/ACC/RUS/70,

The Working Party Report also stipulates that “the Russian Federation would apply export duties in conformity with the WTO Agreement, in particular with Article I of the GATT 1994.”[82] Recall that in *China – Publications and Audiovisual Products* and *China – Raw Materials*, the Appellate Body recognized the importance of a cross-reference to the WTO Agreement or to articles in the WTO agreements.[83]

Lao People’s Democratic Republic undertook to “comply with GATT 1994 and WTO provisions with regard to export duties.”[84]

Tajikistan’s commitments on export duties are similar to those in China’s Accession Protocol. Tajikistan thus agreed that it “shall not introduce and shall eliminate all duties, taxes, fees and charges applied to exports, unless specifically provided for in Table 9 of this Protocol or applied in conformity with the provisions of Article VIII of the GATT 1994”.[85]

Kazakhstan undertook commitments similar to those undertaken by Russia, namely not to apply export duties to the products listed in Part V of its Goods Schedule in excess of the duties provided for therein.[86] Kazakhstan furthermore undertook not to apply “other measures having an equivalent effect to export duties

17 November 2011, para. 638. Paragraph 2 of Russia’s Accession Protocol incorporates the paragraphs referred to in paragraph 1450 of Russia’s Working Party Report, including paragraph 638. (WTO, Protocol on the Accession of the Russian Federation to the World Trade Organization, WT/L/839, 17 December 2011, para. 2)).

[82]WTO, Report of the Working Party on the Accession of the Russian Federation to the World Trade Organization, WT/ACC/RUS/70, 17 November 2011, para. 638.

[83]See Appellate Body Reports, *China – Publications and Audiovisual Products*, para. 222; and *China – Raw Materials*, paras. 303–307.

[84]WTO, Report of the Working Party on the Accession of Lao People’s Democratic Republic to the World Trade Organization, WT/ACC/LAO/45, 1 October 2012, para. 101. Paragraph 101 is not one of the paragraphs referred to in paragraph 248 of Lao People’s Democratic Republic’s Working Party Report and incorporated through paragraph 2 of Lao People’s Democratic Republic Accession Protocol. (See WTO, Protocol of Accession of Lao People’s Democratic Republic’ to the World Trade Organization, WT/L/865, 29 October 2012, para. 2; and Report of the Working Party on the Accession of Lao People’s Democratic Republic to the World Trade Organization, WT/ACC/LAO/45, 1 October 2012, para. 248). This, presumable due to the fact that Lao People’s Democratic Republic did not undertake commitments with respect to export duties in addition to those contained in the WTO agreements.

[85]WTO, Report of the Working Party on the Accession of the Republic of Tajikistan to the World Trade Organization, WT/ACC/TJK/30, 6 November 2012, para. 169. Paragraph 2 of Tajikistan’s Accession Protocol incorporates the paragraphs referred to in paragraph 351 of Tajikistan’s Working Party Report, including paragraph 169. (WTO, Protocol on the Accession of the Republic of Tajikistan to the World Trade Organization, WT/L/872, 11 December 2012, para. 2).

[86]WTO, Report of the Working Party on the Accession of the Republic of Kazakhstan to the World Trade Organization, Schedule CLXXII, WT/ACC/KAZ/93/Add.1, 23 June 2015, Part V.

on those products" and to "apply export duties in conformity with the WTO Agreement, in particular with Article I of the GATT 1994".[87]

Afghanistan made a commitment that it "would not introduce and would eliminate all duties, taxes, fees and charges applied to exports ... unless specifically provided for in Annex 12 to this Report or applied in conformity with the provisions of Article VIII of the General Agreement on Tariffs and Trade 1994".[88] The obligation to eliminate all duties, taxes, fees and charges applied to export does, however, not apply to Afghanistan's 2 % fixed tax on exports until January 2021.[89]

4 Some Multilateral Systemic Issues Raised in the Recent Years

Export restrictions can have impacts in a number of broader, systemic areas. Below, the impacts of export restrictions on food security, sustainable development, and environmental protection are considered.

4.1 Food Security and Export Restrictions on Agricultural Products

Export restrictions on agricultural products can be used for purposes of achieving food security. This tendency was especially obvious during the 2007–2008 food crisis.

[87]WTO, Report of the Working Party on the Accession of the Republic of Kazakhstan to the World Trade Organization, WT/ACC/KAZ/93, 23 June 2015, para. 540. Like Russia, Kazakhstan furthermore undertook to "administer export tariff rate quotas (TRQs) in a manner that is consistent with the WTO Agreement and in particular the WTO General Agreement on Tariffs and Trade 1994 and the WTO Agreement on Import Licensing Procedures." (WTO, Report of the Working Party on the Accession of the Republic of Kazakhstan to the World Trade Organization, WT/ACC/KAZ/93, 23 June 2015, para. 540). Paragraph 2 of Kazakhstan's Accession Protocol incorporates the paragraphs referred to in paragraph 1175 of Kazakhstan's Working Party Report, including paragraph 540. (WTO, Protocol on the Accession of the Republic of Kazakhstan to the World Trade Organization, WT/L/957, 30 July 2015, para. 2).

[88]WTO, Report of the Working Party on the Accession of the Islamic Republic of Afghanistan to the World Trade Organization, WT/ACC/AFG/36, 13 November 2015, para. 145. Paragraph 2 of Afghanistan's Accession Protocol incorporates the paragraphs referred to in paragraph 301 of Afghanistan's Working Party Report, including paragraph 145. (WTO, Protocol on the Accession of the Islamic Republic of Afghanistan to the World Trade Organization, WT/L/974, 21 December 2015, para. 2). Part V of Afghanistan's Goods Schedule lists the bound rates for Afghanistan's export duties. (WTO, Report of the Working Party on the Accession of the Islamic Republic of Afghanistan to the World Trade Organization, Schedule CLXX, WT/ACC/AFG/36/Add.1, 13 November 2015, Part V).

[89]WTO, Report of the Working Party on the Accession of the Islamic Republic of Afghanistan of the World Trade Organization, WT/ACC/AFG/36, 13 November 2015, para. 145.

4.1.1 The Use of Export Restrictions During the 2007–2008 Food Crisis

In the recent food crisis in 2007–2008, export restrictions were utilized widely by countries. A FAO study in 2011 found that 31 % of countries had used export restrictions.[90] The study found that countries typically used, sequentially or at the same time, more than one export restriction such as duties, quotas, and minimum export prices.[91] In East Asia and South Asia, 40 % of countries implemented export restrictions, and in Europe and Central Asia, 35 % of countries implemented these measures.[92] The statistics for Africa, Latin America, the Caribbean, the Middle East, and North Africa were lower, where around 20 % of the countries implemented export restrictions.[93]

Many countries, including China, India, and Viet Nam, imposed restrictions on grain exports in 2007 and 2008, claiming that conservation of local food production would reduce food prices. Other countries reacted by introducing their own export restrictions on food products, arguing that such action was necessary since the originally imposed export restrictions would reduce their access to imports of food. These restrictions exacerbated existing supply constraints by globally driving up prices even more.[94]

The relationship between food security and the use of export restrictions has sparked a vigorous debate among policy makers and economists in the aftermath of the 2007–2008 food crisis. Martin and Andersen attribute 45 % of the price increase in rice during the crisis to the attempts by countries to insulate their domestic markets, including through the use of export restrictions.[95] Howse and Josling critically note that despite the increasingly obvious link established by studies between food price increases and the use of export restrictions, much of the discourse around the United Nations (UN) enshrined Right to Food seems to increasingly imply a right to self-sufficiency regardless of competitiveness, trade distortions, and domestic consumer prices.[96]

Indeed the food crisis intensified the debate for stricter disciplines on the use of export restrictions. One could question the efficacy of strengthening current disciplines on quantitative export restrictions when, as noted above, the WTO agreements do not provide for any disciplines on the use of export duties. As Howse and Josling have noted, even if the policy option of imposing quantitative export

[90]Sharma (2011), p. 8.

[91]Sharma (2011), p. 8.

[92]Howse and Josling (2012), p. 6.

[93]Howse and Josling (2012), p. 6.

[94]See generally Headey (2010). Headey examines the role of trade-related factors on the price increases in important international grain markets, namely the rice, wheat, maize, and soybean markets.

[95]Martin and Andersen (2010), p. 10 (referenced in Howse and Josling (2012), p. 5).

[96]Howse and Josling (2012), pp. 10–11. See also Karapinar and Häberli (2010).

restrictions is not available to WTO Members, Member governments may still impose export duties because of the lack of disciplines in that area.[97]

4.1.2 The Agreement on Agriculture and "Due Consideration" to Food Importing Countries

As noted, the AoA contains additional rules on export restrictions for food shortage in Article 12. Howse and Josling contend that the notion of Article 12 of the AoA as "soft law" should be reconsidered in light of the restrictive approach adopted by the Appellate Body to Article XI:2(a) of the GATT 1994.[98] Howse and Josling contend that this shows that there is a "hard law" effect to Article 12 and that a determinative legal meaning should be given to the requirements under Article 12.1(a) and (b).[99]

Article 12.1(a) provides that "due consideration" should be given to the food security of importing WTO Members, when a Member is imposing an export restriction. A "weak" reading of this provision would simply attribute a purely procedural meaning to the provision that the needs of importing WTO Members should be taken into account when making decisions as to the imposition of new export restrictions. Under this reading there is no substantive requirement on the actual export restricting measure that its design must reflect due consideration of importing Members' food security.[100]

4.2 Export Restrictions and Sustainable Development

It has been suggested that exceptions should be introduced so that in certain circumstances, some Members should be entitled to maintain export restrictions. For example, a study of the use of export restrictions and duties across nine low income countries in Africa, using data gathered from TPRs, found that the most

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[97]Howse and Josling (2012), p. 17. Howse and Josling question whether export duties that are designed to have the same economic impact, and the same protectionist intent, as the kinds of measures disciplined under Article XI:1 of the GATT 1994 should be viewed as exempt duties. For these authors, the broad scope of Article XI:1 identified by the Panel in *India – Autos* provides a basis for interpreting the meaning of exempted export duties narrowly, excluding those with predominantly trade restricting effects, as opposed to those implemented for revenue-raising purposes. According to Howse and Josling, the fact that disciplines in Article VIII on fees and charges do not prevent the use of export taxes and duties as permitted by Article XI, also indicates that export duties exempted from the ban in Article XI:1 should be understood as measures imposed for fiscal revenue-raising purposes, not trade restricting ones (Howse and Josling (2012), pp. 17–18).

[98]Howse and Josling (2012), pp. 15–16 (referring to Appellate Body Report, *China – Raw Materials*).

[99]Howse and Josling (2012), pp. 15–16.

[100]Howse and Josling (2012), p. 15.

commonly cited objectives for the implementation of export restrictions include promoting value addition in the supply chains, environmental protection, and food security.[101] Export duties provide an important source of revenue for low income countries,[102] and can provide incentives to promote economic diversification and higher value added activities. Their use could, in some circumstances, be justified for the benefit of sustainable development.[103]

It is also argued that the implementation of restrictions on the export of inputs entails that a country can lower the price of these inputs for domestic downstream manufacturers, who will in turn gain a price advantage in the export markets. Such restrictions help grow infant manufacturing industries, while the increase in exports of the downstream manufacturers' goods will generate higher export and tax revenue as well as sustaining and creating domestic jobs.[104]

However, the implementation of these measures often promotes industries which are inefficient or do not have a comparative advantage. In addition, the benefits of these policies could be offset if other countries impose export restrictions in response to the original export restrictions imposed.[105]

4.3 Export Restrictions and Environmental Protection

Environmental protection or the conservation of exhaustible natural resources such as fresh water, fisheries, forestry or minerals could also be the objective behind the implementation of export restrictions. Countries may want to prevent or slow down the depletion of their natural resources, or may simply choose to keep them for the benefit of future generations.[106]

There has been much debate around the potential use of border carbon adjustment measures by countries as a way to drive momentum on the climate change agenda, and to incentivize countries with large manufacturing and carbon-intensive industries to join a multilateral agreement on climate change.[107]

In the climate change context, two types of border carbon adjustments may be implemented: price-based and non-price-based measures. Under the latter type,

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[101] See Karapinar, pp. 7–10. Karapinar includes a full review of the export restrictions and duties in place on hydrocarbons and minerals in nine low income countries, namely Cameroon, the Republic of Chad, the Democratic Republic of the Congo, Ghana, the Republic of Guinea, the Islamic Republic of Mauritania, Nigeria, the Republic of Sierra Leone, and the Republic of Zambia.

[102] For example, 10 % of government income in Côte d'Ivoire comes from export duties on cocoa (Mitra and Josling (2009), p. 4).

[103] Karapinar, p. 3.

[104] Karapinar, p. 3.

[105] Karapinar (2011), p. 1141.

[106] Karapinar (2011), p. 1141.

[107] Guardian (2012).

market access is limited to products that comply with specific standards, for instance, the level of greenhouse gas (GHG) emissions ensuing from the production of a product. Price-based border adjustments can be applied on imports in two different manners: (i) border tax adjustments on imports; and (ii) mandatory carbon offset purchases of either GHG emission permits or allowances by importers.[108]

Border carbon adjustments can also be applied with respect to exports, for instance in the form of carbon export duties. Such export duties would create an incentive for producers to invest in low carbon emission production and processing methods, which would result in reduced carbon emissions ensuing from this production.[109] Holzer and Karapinar argue that such export duties are likely to counteract and even compete with border adjustment measures imposed by importing countries which could have an impact on GHG emissions and competitiveness.[110] As pointed out by Holzer and Karapinar, exporting countries are likely to prefer imposing their own carbon export duties rather than facing import carbon border adjustment measures since the revenue generated through a carbon export duty stays in the exporting country and thus allows the exporting country to retain the revenue instead of allowing their exporters to be exposed to border carbon adjustment measures in the importing countries. Such export price measures must nonetheless respect WTO rules such as the MFN principle in Article I of the GATT 1994.[111]

5 Disciplines on Export Restrictions in Regional Trade Agreements

Korinek and Bartos, in a study published by the Organization for Economic Co-operation and Development (OECD), analyzed the additional restrictions and disciplines that have been placed on the use of export restrictions and export duties in RTAs.[112] *WTO-plus* commitments are defined as those that regulate or forbid the use of export restrictions where the WTO allows them or does not prohibit them. *WTO-minus* commitments are defined as those that allow export restrictions in situations where the WTO does not. RTAs are classified as *WTO-equal* for the purposes of the study when they neither improve upon nor regress from the WTO obligations. Since the WTO agreements do not provide for any disciplines on export duties, any RTA that provides for disciplines on export duties are classified as *WTO-plus* for the purposes of the study.[113]

[108]Low et al. (2012), p. 488.

[109]Holzer and Karapinar (2012), p. 26.

[110]Holzer and Karapinar (2012), p. 17.

[111]Holzer and Karapinar (2012), p. 26.

[112]Korinek and Bartos (2012).

[113]Korinek and Bartos (2012), p. 17.

5.1 *Disciplines on Quantitative Export Restrictions in RTAs*

Korinek and Bartos found 15 RTAs with provisions on quantitative export restrictions that were WTO-plus.[114] 22 RTAs imposed weaker disciplines than currently found under the WTO agreements,[115] while 38 RTAs were WTO-equal.[116] 18 RTAs either did not impose disciplines on quantitative export restrictions or failed to mention export restrictions altogether, hereunder a number of well-known RTAs, such as the ASEAN-MERCOSUR, ASEAN-China and ASEAN-India RTAs, the Andean Community, COMESA and ECOWAS.[117] The study finds that there has been a noticeable tendency towards WTO-plus commitments in recent times.[118]

5.1.1 WTO-Plus RTAs

WTO-plus RTAs can be divided into two subgroups: agreements that impose conditions on the use of the exceptions provided for in Articles XI:2(a) and XX of the GATT 1994, and those agreements that allow fewer exceptions than the WTO agreements.

Agreements That Impose Conditions on the Use of Exceptions

The first subgroup of WTO-plus agreements includes three RTAs, namely the Canada-Chile and Canada-Costa Rica RTAs, and NAFTA. These RTAs are considered WTO-plus because they place additional conditions on the use of the exception clauses provided for in the WTO agreements. While all three RTAs incorporate GATT Articles XI:2(a) and XX, their application is limited to instances where the party imposing a quantitative export restriction justified under GATT Articles XI:2(a) or XX(g), XX(i), or XX(j) shows that this restriction meets two conditions[119]: First, the export restriction must not reduce the proportion of total exports made available to the other parties to the RTA in comparison to the total supply of the good from the party imposing the export restriction compared to the

[114]Korinek and Bartos (2012), p. 23. These include: the Canada-Chile RTA, the Canada-Costa Rica RTA, NAFTA, the EC-South Africa RTA, the EFTA-Israel RTA, the EU, CEFTA 2006, and the EC-CARIFORUM RTA.

[115]Korinek and Bartos (2012), p. 18. These include the US-CAFTA RTA, the US-Colombia RTA, the MERCOSUR-Bolivia RTA, the MERCOSUR-Chile RTA, the EFTA-Colombia RTA, the EFTA-Ukraine RTA, and CARICOM.

[116]Korinek and Bartos (2012), p. 22.

[117]Korinek and Bartos (2012), p. 18.

[118]Korinek and Bartos (2012), p. 34.

[119]Korinek and Bartos (2012), p. 23.

last 36 months. Thus, if a party to one of these RTAs wants to impose an export restriction, it must ensure that it can continue to export the same proportion of total supply to the other parties to the RTA. Second, the export restriction must not require disruption of normal channels of supply or normal proportions among specific goods supplied to the other RTA parties.[120]

Rather than eliminating quantitative export restrictions entirely as a policy option for the parties to the RTA, these provisions mitigate the negative impacts of export restrictions on importers in other parties to the RTA, since the parties are obliged to continue to supply the same proportion of the product in question to RTA parties if they impose an export restriction.[121]

Agreements with Fewer Exceptions Than the WTO

The second subgroup of WTO-plus agreements covers 12 RTAs. These RTAs go beyond the WTO disciplines by providing for fewer exceptions to the ban on quantitative export restrictions than that of WTO agreements. Of these 12 RTAs, the ones containing the fewest exceptions are the EC-South Africa, EFTA-Israel and EC-Israel RTAs, the EU, and CEFTA 2006.[122] Generally, a wide variety of the exceptions provided for in the WTO agreements are eliminated in the 12 RTAs.[123] 11 of the 12 RTAs thus eliminate the exception in GATT Article XX(j) for restrictions "essential to the acquisition or distribution of products in general or in local short supply". Five of the 12 RTAs eliminate the exception in GATT Article XX(g) for exhaustible natural resources. Nine of the 12 RTAs eliminate the exception in GATT Article XX(i) for domestic stabilization plans.[124] The EC-South Africa RTA, CEFTA 2006, EFTA, the EFTA-Israel RTA, the EU, and the EFTA-Chile RTA all eliminate the exception in GATT Article XI:2(a) for critical shortages of foodstuffs or other essential products entirely, while the EC-CARIFORUM and EC-Côte d'Ivoire RTAs limit the scope of application for this exception to apply to foodstuffs only, and not other essential products.[125]

5.1.2 WTO-Minus RTAs

In total, 22 RTAs were found to be WTO-minus. These agreements are considered WTO-minus since they allow for the use of quantitative export restrictions on goods

[120] Korinek and Bartos (2012), p. 23. In the Canada-Chile RTA, however, there is an exemption for copper from this provision.

[121] Korinek and Bartos (2012), p. 23

[122] Korinek and Bartos (2012), p. 23.

[123] Korinek and Bartos (2012), p. 23.

[124] Korinek and Bartos (2012), p. 23.

[125] Korinek and Bartos (2012), p. 23.

where the WTO does not, typically by allowing parties to the RTA to impose export restrictions on specific agricultural products.[126] Such restrictions do not require the context of a domestic stabilization plan or a shortage of foodstuffs, rather their applicability is at the discretion of the RTA party. For example, the US-CAFTA-Dominican Republic RTA allows several parties to maintain export restrictions on specific goods: Nicaragua can thus put restrictions in place for up to 1 year on a positive list of foodstuffs at its own discretion.[127]

More controversial from a systemic point of view is the question of compatibility of WTO-minus agreements with GATT Article XXIV which allows for the formation of RTAs[128] and customs unions. Article XXIV provides for agreements that "facilitate trade" and do not "raise barriers" to trade. Article XXIV:8(b) defines a free-trade area as one where duties and other restrictive regulations of commerce are "eliminated on *substantially all the trade* between the constituent territories in products originating in such territories".[129]

In *Turkey – Textiles*, the Appellate Body considered Article XXIV of the GATT 1994 in the context of the customs union between Turkey and the EC and found that this provision may provide justification for measures that are otherwise inconsistent with certain other GATT provisions, provided two cumulative conditions are fulfilled: (i) the measure at issue is introduced upon the formation of a customs union (or a free-trade area) that fully meets the requirements of Article XXIV; and (ii) the formation of that customs union (or free-trade area) would be prevented if the measure could not be introduced.[130]

The issue of justifying WTO-inconsistent measures under Article XXIV of the GATT 1994 was also raised in *Peru – Agricultural Products*. In this dispute, the Appellate Body stated that the *lex specialis* provisions in the WTO agreements on amendments, waivers, or exceptions for RTAs, in particular Article XXIV of the GATT 1994, would prevail over the general rule in Article 41 of the Vienna Convention on the Law of Treaties regarding modifications of multilateral treaties.[131] The Appellate Body, referring to the purpose of a customs union or a free-trade area being "'to facilitate trade' between the constituent members" and "'not to raise barriers to the trade' with third countries", generally stated that the

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[126]Korinek and Bartos (2012), p. 18. The exceptions do not provide that controls must be in place domestically, as is required by the exception in GATT Article XX(g) for exhaustible natural resources.

[127]Korinek and Bartos (2012), p. 19.

[128]Referred to in Article XXIV of the GATT 1994 as a "free trade area".

[129]GATT Article XXIV. (emphasis added). For full text and interpretive notes, see WTO website, https://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_09_e.htm

[130]Appellate Body Report, *Turkey – Textiles*, para. 58.

[131]Appellate Body Report, *Peru – Agricultural Products*, para. 5.112.

Article XXIV exception should not be interpreted as a broad defense for provisions in RTAs that roll back on Members' rights and obligations.[132]

The role of Article XXIV of the GATT 1994 was also highlighted in *Brazil – Retreaded Tyres* where Brazil attempted to justify certain GATT violations with reference to MERCOSUR provisions. The Appellate Body was clear that justifications for a violation of a WTO provision is to be found in the WTO agreements, by interpreting and applying WTO provisions consistently with international law. In that dispute Brazil did not invoke GATT Article XXIV, but only Article XX(b). The Appellate Body concluded that the MERCOSUR exemption to Brazil's import ban, introducing discrimination between parties to MERCOSUR and other WTO Members, could not be justified under GATT Article XX(b) as it constituted a means of arbitrary and unjustifiable discriminations, contrary to the chapeau of GATT Article XX.[133]

5.1.3 WTO-Equal RTAs

RTAs are classified as WTO-equal for the purposes of Korinek and Bartos' study when they neither improve upon nor regress from WTO obligations. Thirty-eight RTAs were found to contain WTO-equal provisions on quantitative export restrictions. Many of these RTAs follow the approach in the GATT 1994 by incorporating a general ban on quantitative export restrictions and adding a list of situational exceptions and exceptions for specific goods. Some RTAs exclude larger categories of goods from the ban's scope of application but, at the same time, eliminate the exceptions for restrictions on exhaustible natural resources, domestic stabilization plans and products in general or local short supply found in GATT Articles XX(g), XX(i), and XX(j). Although the provisions of these RTAs are not identical to those in the WTO agreements, they are nevertheless considered WTO-equal based on a weighing of the elements going beyond the WTO disciplines and those that are weaker than the WTO disciplines.[134]

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[132] Appellate Body Report, *Peru – Agricultural Products*, para. 5.116. Since Peru had not invoked Article XXIV of the GATT 1994 as a justification for the WTO inconsistency of its measure and the RTA had not entered into force, the Appellate Body did however not consider whether the measure at issue was consistent with the requirements in Article XXIV. (Appellate Body Report, *Peru – Agricultural Products*, para. 5.117).

[133] Appellate Body Report, *Brazil – Retreaded Tyres*, paras. 228–234. Pauwelyn argues that WTO panels and the Appellate Body "do everything to avoid [challenges to RTAs]", referring to the fact that the Panel and Appellate Body in *Turkey – Textiles* presumed that the EC-Turkey customs union met the requirements in Article XXIV and that the Panel in *Brazil – Retreaded Tyres* avoided any examination of this issue (Pauwelyn (2007), pp. 2–3).

[134] Korinek and Bartos (2012), p. 22.

5.2 *Disciplines on Export Duties in RTAs*

As explained above, the GATT 1994 does not include any direct disciplines regulating the use of export duties. Therefore, an RTA is considered WTO-equal if it contains no language on export duties or explicitly allows for the use of such duties.[135] Twenty-seven of the surveyed 93 RTAs contain no language on export duties and can thus be considered WTO-equal. The remaining 66 agreements are considered WTO-plus because they go beyond the WTO by disciplining the use of export duties.[136]

5.2.1 WTO-Plus RTAs

Agreements Prohibiting New Export Duties (Taxes) or Increases in Existing Duties (Taxes)

The first subgroup of RTAs that can be considered to be WTO-plus contains RTAs which allow the parties to the RTA to maintain existing export duties but prohibit the introduction of new duties and increases in the level of existing ones. Many of these RTAs include exceptions to the prohibition on new export duties and increases in existing ones. For instance, under the EC-Côte d'Ivoire RTA, in exceptional circumstances, Côte d'Ivoire is permitted to apply new or increased temporary export duties on a limited number of traditional goods if such duties are justified by the need for income, infant industry protection or environmental protection. In addition, the RTA contains a general exception for Côte d'Ivoire, allowing it to take appropriate measures, which could presumably involve new or increased export duties, to ensure food security.[137]

This type of export duty discipline is particularly prevalent in RTAs involving Argentina, where export duties are applied on a large number of goods.[138]

Although categorized as WTO-plus RTAs, Korinek and Bartos point out that the disciplines on export duties in these RTAs are light and can be further undermined by the inclusion of broad exceptions.[139]

[135] Korinek and Bartos (2012), p. 24.

[136] Korinek and Bartos (2012), p. 24.

[137] Korinek and Bartos (2012), p. 25.

[138] In the MERCOSUR-Chile and MERCOSUR-Bolivia RTAs, Argentina has provided for the use of various export duties on products (See Korinek and Bartos (2012), p. 24). In the MERCOSUR-Bolivia RTA, Brazil reserves the right to impose export duties of on various products. Brazilian domestic law allows for the application of an export tax of up to 150 % (See Korinek and Bartos (2012), p. 24).

[139] Korinek and Bartos (2012), p. 25.

Agreements Imposing a General Prohibition on Export Duties

Fifty-five of the 66 WTO-plus RTAs prevent parties from maintaining existing export duties and adopting new ones.[140] Most of these RTAs apply an approach similar to that in the GATT 1994, namely a general ban on export duties with certain exceptions, usually some or all of the exceptions found in Articles XI:2 (a) and XX of the GATT 1994. Many RTAs, however, also include additional exceptions to the ban on export duties in addition to such exceptions.[141]

Forty-five RTAs were thus found to include both situational and product specific exceptions to the general ban on export duties. Examples of exceptions for specific products are RTAs that exempt broad categories of agricultural products from the general ban and RTAs that exempt only a few specific cross-sector goods. Such product specific exceptions are combined with situational exceptions such as those found in GATT Articles XX(i) and XX(j) or in case of threat of re-export to a country not party to the RTA against which the exporting party maintains an export duty.[142] NAFTA and the Canada-Chile and Canada-Costa Rica RTAs incorporate the exceptions in GATT Articles XI:2(a) and XX but go further by imposing additional conditions on the use of these exceptions. Parties to these RTAs can thus only invoke these exceptions as justifications for export duties if the export price charged to other parties to the RTA is not higher than the price charged domestically.[143]

Some RTAs only include product specific exceptions to the general ban on export duties, and not situational exceptions such as those in Articles XI:2(a), XX (i) and XX(j) or those applied in cases involving threat of re-export to a country not party to the RTA.[144] Another group of RTAs, on the other hand, only includes such situational exceptions to the general ban on export duties, and not product specific ones.[145]

5.2.2 WTO-Minus RTAs

Since the GATT 1994 does not include any direct disciplines on export duties, none of the surveyed RTAs can be considered to impose weaker disciplines. Consequently, none of the surveyed RTAs can be categorized as WTO-minus.

[140]Korinek and Bartos (2012), p. 25.

[141]Korinek and Bartos (2012), p. 25.

[142]Korinek and Bartos (2012), pp. 25–28.

[143]Korinek and Bartos (2012), p. 28.

[144]Korinek and Bartos (2012), p. 28.

[145]Korinek and Bartos (2012), p. 29.

5.2.3 WTO-Equal RTAs

As mentioned above, 27 of the surveyed RTAs either did not contain language on export duties or explicitly allowed for such export duties. These 27 RTAs were therefore considered WTO-equal.[146]

6 Proposals for Reform

Proposals for reforming the current disciplines on export restrictions have been suggested in different fora. Below, a number of these proposals are examined.

6.1 Doha Round Proposals for Reform and G20 Negotiations

In 2008, Japan and Switzerland proposed constraining Members' ability to restrict food exports and requiring them to consider how such policies affect Members that depend on food imports. Specifically, they called for a Doha Round agreement to require any new export prohibition or restriction to be "limited to the extent strictly necessary" in light of production, stocks, and domestic consumption.[147] The proposal would oblige Members to give "due consideration" to the effect on importing Members' food security when instituting new export restrictions, in particular "(i) food imports which would otherwise occur in importing Members in the absence of such prohibition or restriction, and (ii) secured implementation of food aid toward net food-importing developing countries".[148]

In addition, Members would be required to notify the WTO Committee on Agriculture before instituting export restrictions, specifying the nature, duration, and reasons for the measure. Furthermore, governments would be required to consult with importing Members about "any matter related to the proposed [export restriction] in question". If consultations fail to produce an agreement within 60 days, the measure would be referred to a "standing committee of experts" for binding arbitration. Any new export restriction would be stayed pending the consultations and the judgment of the standing committee.[149]

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[146]Korinek and Bartos (2012), p. 24.

[147]WTO, Proposal on Export Prohibitions and Restrictions, Communication from Japan and Switzerland, JOB(08)/34, 30 April 2008, p. 1.

[148]WTO, Proposal on Export Prohibitions and Restrictions, Communication from Japan and Switzerland, JOB(08)/34, 30 April 2008, p. 1.

[149]WTO, Proposal on Export Prohibitions and Restrictions, Communication from Japan and Switzerland, JOB(08)/34, 30 April 2008, p. 1.

The proposed requirements to give "due consideration" to the food security of importing Members, to notify the WTO Committee on Agriculture of the nature and the duration of the export restriction and to consult with importing Members about any matter related to the proposed export restriction are similar to the already existing requirements of Article 12 of the AoA, although this provision does not contain the possibility of referring the matter to binding arbitration.[150]

Howse and Josling point out that the latest modalities text, namely the Draft Modalities of December 2008, was not as extensive as the proposal by Japan and Switzerland. The 2008 Draft Modalities would thus require notification of export restrictions within 90 days after the imposition of such export restrictions, not prior to the imposition.[151] It calls for export restrictions to normally last no longer than 1 year, with importing Members' consent being required for measures that last longer than 18 months. The modalities also include an exemption from these requirements for least-developed and net food-importing country Members. Given the impasse of the overall Doha Round negotiations, these modalities have not yet been agreed.[152]

The EC proposed various notification requirements and stricter disciplines on the use of export duties to ensure the "[c]onfirmation and operationalisation of basic GATT Principles to apply to those situations where WTO Members use export taxes for industrial or trade policy purposes with negative effects on other WTO Members and especially on developing countries"; "[i]ncorporation of additional flexibility for small developing country Members and least-developed country Members to maintain or introduce export taxes in other situations, i.e. over and beyond what would be allowed through the strict application of GATT rules to export taxes"; and "[l]imitation of the GATT disciplines for export taxes to non-agricultural products in recognition of the mandate for NAMA (hence, agricultural products are excluded where export taxes are currently in force in many developing countries)".[153]

[150]Article 12 of the AoA is described in more detail in Sect. 2.1.1 above. For full text and interpretive notes, see WTO website, https://www.wto.org/english/res_e/booksp_e/analytic_index_e/agriculture_02_e.htm#article12.

[151]Howse and Josling (2012), p. 13; For relevant texts, see https://www.wto.org/english/tratop_e/agric_e/negs_bkgrnd09_taxes_e.htm. The 2008 Draft Modalities were based on a proposal by the G20. (See G20, Leaders' Statement, The Pittsburgh Summit; and G20, Multi-Year Action Plan on Development, Food Security Pillar).

[152]Howse and Josling (2012), p. 13; For relevant texts, see https://www.wto.org/english/tratop_e/agric_e/negs_bkgrnd09_taxes_e.htm

[153]WTO, Market Access for Non-Agricultural Products, Revised Submission on Export Taxes, Communication from the European Communities, TN/MA/W/101, 17 January 2008, p. 2. More specifically, the EC proposed that "(1) WTO Members should notify the introduction or modification of export taxes; and (2) WTO Members should undertake to schedule export taxes on non-agricultural products in their Schedules of Concessions and bind the export taxes at a level to be negotiated, except that: (a) Least-developed countries would undertake to schedule export taxes but may maintain these export taxes unbound; and (b) Paragraph 6 countries would schedule export taxes but may maintain these export taxes unbound for a certain number of tariff lines (the

The United States proposed to "prohibit the use of export taxes, including differential export taxes, for competitive advantage or supply management purposes"[154] and to "strengthen substantially WTO disciplines on export restrictions to increase the reliability of global food supply".[155] In 2008, Japan and the United States proposed reforms to enhance transparency around export licensing. The proposed reforms included the introduction of detailed notification requirements for existing and new measures on export licensing, including, among others, a list of products subject to the licensing procedure, a description of application procedures including eligibility criteria for applicants, a description of the measure being implemented through the export license and the reasons for the measure, details on the expected duration of the export licensing, and the possibility, if any, for requesting exceptions or derogations from the export licensing requirement.[156]

In 2011, the European Union (EU), on behalf of 14 Members,[157] proposed "to remove food export restrictions or extraordinary taxes for food purchased for non-commercial humanitarian purposes by the WFP (World Food Programme)" and "not to impose them in the future", following the adaptation of an Action Plan on Food Price Volatility and Agriculture at the G20 Summit in Seoul.[158] The Net Food-Importing Developing Countries (NFIDCs), African and Arab Groups proposed setting up a WTO Work Programme to Mitigate the Impact of the Food Market Prices and Volatility on WTO Least-Developed and Net-Food Importing Developing Members which could include developing rules to exempt purchases of least-developed country Members and net food-importing developed country Members from quantitative export restrictions invoked under Article XI:2(a) of the GATT 1994 and exploring the mechanisms required to provide financing to address the short-term difficulties that least-developed country Members and net food-importing developed country Members face in financing their food imports.[159]

number is to be negotiated), in reflection of their specific developmental interests and concerns." (WTO, Market Access for Non-Agricultural Products, Revised Submission on Export Taxes, Communication from the European Communities, TN/MA/W/101, 17 January 2008, p. 3).

[154]WTO, Proposal for Comprehensive Long-Term Agricultural Trade Reform, Submission from the United States, G/AG/NG/W/15, 23 June 2000, p. 3.

[155]WTO, Proposal for Comprehensive Long-Term Agricultural Trade Reform, Submission from the United States, G/AG/NG/W/15, 23 June 2000, p. 6.

[156]WTO, Protocol on Transparency in Export Licensing to the General Agreement on Tariffs and Trade 1994, Enhanced Transparency on Export Licensing, Communication from Japan and the United States, TN/MA/W/15/Add.4/Rev.1, 11 April 2008, p. 2.

[157]Australia, Canada, Chile, Costa Rica, the EU, Korea, Indonesia, Japan, Mexico, Norway, the Kingdom of Saudi Arabia, Singapore, Switzerland, and Turkey.

[158]WTO, Food Export Barriers and Humanitarian Food Aid by the WFP (World Food Programme), Communication from the European Union, WT/GC/138, 18 November 2011, p. 2.

[159]WTO, The WTO Response to the Impact of the Food Crisis on LDCs and NFIDCs, Communication from the NFIDCs, African and Arab Groups, WT/GC/140/Rev.1, 25 November 2011, p. 1.

6.2 *Reforms Based on Experiences in RTAs*

As mentioned in Sect. 5, many RTAs go beyond the WTO agreements in disciplining the use of export restrictions. It is therefore relevant to look at such RTAs as inspiration for reforms of the multilateral system.

6.2.1 Narrowing the GATT Article XI:2(a) Exception

Across the RTAs surveyed in the OECD study, Korinek and Bartos found that many RTAs refine the situational exceptions by limiting their scope. Many RTAs narrow the GATT Article XI:2(a) exception for "shortages of foodstuffs or other products essential to the exporting contracting party" so that only shortages of foodstuffs justify an exception. Korinek and Bartos point out that this group of RTAs includes countries in different regions and at different levels of development, which could indicate that this type of reform is amenable to the multilateral community.[160]

In a 2010 International Centre for Trade and Sustainable Development (ICTSD) Issue Paper, Anania has proposed a similar reform, with narrow situational exceptions to the general prohibition on quantitative export restrictions. Anania suggests the inclusion of an exception so that developing countries acting on food security concerns would be allowed to use, on a temporary basis, export restricting policies. The choice could span from facilitating all developing countries to avail themselves of this exception to restricting the use of export restrictions to least developed countries only.[161]

6.2.2 Procedural Rules for the Use of Export Restrictions

Article 12 of the AoA refers to specific consultation and notification obligations for the introduction of export restrictions on agricultural products. Anania suggests making these existing disciplines more stringent and effective by introducing a notification and implementation procedure similar to that jointly proposed by Japan and Switzerland in 2008.[162] A number of RTAs already include procedural rules for the use of export restrictions. Such procedures could require consultations between

[160]Korinek and Bartos (2012), p. 31. The RTAs include the EC-Côte d'Ivoire RTA, NAFTA, CARICOM, SADC and the EC-CARIFORUM RTA.

[161]Anania (2013), pp. 32–33

[162]Anania (2013), pp. 28–29.

countries before export restrictions can be put in place to determine whether conditions justify the use of such restrictions.[163]

6.2.3 Positive Product List

Some RTAs include a positive list of products rather than general situational exceptions, thereby increasing precision on which products exports may be restricted. NAFTA, for example, includes a positive list of products to which some situational exceptions may apply. Its provisions specify that export duties may be imposed on certain basic foodstuffs in the context of a domestic stabilization plan.[164] Korinek and Bartos suggest that the use of a positive list of products, rather than general situational exceptions that are more open to interpretation, implies a sharper, more precise discipline that may reduce future misunderstandings or disputes.[165] Such a list could also be adopted, by decisions, amendment or otherwise, in the WTO context.

6.2.4 Controlling Market Shares

Anania proposes, that in order to implement export restrictions, countries will have to maintain the share of domestic production of the specific product exported in the recent past, or, alternatively, to guarantee that a given proportion of this share is exported, for instance by having to export a share of domestic production which is no less than 80 % of that observed in a given reference period.[166] This approach would limit the effect of export restrictions on the world market by guaranteeing a similar proportion of supply of the product in question and was included in proposals by Canada in 1999 and Japan in 2000.[167] Anania suggests that with this

[163]Korinek and Bartos (2012), p. 31. Some EC RTAs require parties to submit an application to the RTA's governing committee prior to imposing an export restriction and wait 30 days for a solution to be reached through that committee that is acceptable to all parties. If no solution is reached, the party may impose necessary export restrictions following the expiry of the 30 days. In exceptional and critical circumstances, a party may apply precautionary measures on exports before going to the governing committee but must immediately inform the other RTA parties. Furthermore, export restrictions imposed under any of the exception clauses are subject to periodic consultation between the parties within the governing committee in order to facilitate their elimination as soon as circumstances permit (Korinek and Bartos (2012), pp. 31–32).

[164]Korinek and Bartos (2012), p. 31.

[165]Korinek and Bartos (2012), p. 31.

[166]Anania (2013), p. 30.

[167]Anania (2013), pp. 30–31 (referring to Meilke (2008), p. 151; and WTO, Negotiating Proposal by Japan on WTO Agricultural Negotiations, G/AG/NG/W/91, 21 December 2000). Provisions similar to these proposals are included in NAFTA and in the Canada-Costa-Rica and Canada-Chile RTAs, where they apply on a preferential basis, only to export flows directed to countries that are parties to the specific agreement (Korinek and Bartos (2012), p. 23).

option, the exporting country can restrain increases in domestic prices while allowing domestic producers to benefit from higher international prices.[168]

6.2.5 Prohibiting the Use of Quantitative Export Restrictions on Exports Directed Towards Poor Net Food-Importing Countries

Anania also proposes modifying current disciplines to prohibit the use of quantitative restrictions on exports directed towards poor net food-importing countries. This option thus involves limiting the use of quantitative export restrictions with respect to the countries that are most affected by such export restricting measures, namely poor net food-importing countries with severe food insecurity problems.[169] This element was included in the 2011 proposal by the EU on behalf of 14 Members as well as the 2011 proposal by the NFIDCs, African and Arab Groups (discussed above).[170]

7 Conclusion

The undeniable trend since the Uruguay round, reflected in WTO accession protocols and particularly in the majority of RTAs, has been to impose stricter disciplines on the use of export restrictions. The question of whether regional consensus can turn into a multilateral agreement and reform on this issue remains to be seen.

The momentum witnessed in the aftermath of the food crisis towards an international consensus on the use of export restrictions appears to have stalled in recent years. The 2007–2008 food crisis shows the systemic implications of these measures for sustainable development and food security, but action, in the form of reforms, remains to be seen.

In light of the lack of progress in further regulating the use of export restrictions, it should be noted that alternative approaches to mitigating the effects of export restrictions have been suggested and pursued by WTO Members and academics. While it falls outside the scope of this chapter to provide a detailed analysis of the different options, the various options will briefly be presented.

[168] Anania (2013), p. 30.

[169] Anania (2013), pp. 31–32.

[170] WTO, Food Export Barriers and Humanitarian Food Aid by the WFP (World Food Programme), Communication from the European Union, WT/GC/138, 18 November 2011; and The WTO Response to the Impact of the Food Crisis on LDCs and NFIDCs, Communication from the NFIDCs, African and Arab Groups, WT/GC/140/Rev.1, 25 November 2011.

The first category of options deals with mitigating the competitive advantage offered to domestic downstream manufacturers using inputs subject to export restrictions. Export restrictions may lower the prices of such inputs and thus offer a competitive advantage to the domestic downstream manufacturers: Some Members employ a practice of treating export restrictions on inputs as a subsidy to domestic downstream manufacturers, and consequently impose countervailing duties on imports of the downstream products. This practice has been challenged in WTO dispute settlement proceedings, resulting in findings indicating that such practices are WTO inconsistent.[171] Most recently, in *US – Countervailing Measures* (*China*), the Panel found that the United States had not proved that the Chinese government "entrusted" or "directed" Chinese producers of magnesia and coke to provide these goods to domestic downstream manufacturers in the sense of Article 1.1(a)(1)(iv) of the SCM Agreement by imposing export restrictions on such goods.[172]

Another practice among Members is to include considerations regarding export restrictions on inputs when calculating "normal value" for the purposes of determining whether dumping of an imported product has taken place and the dumping margin of imports found to be dumped. The EU Basic Anti-Dumping Regulation allows for determining "normal value" by using third market prices or "constructed normal value" where, because of the particular market situation of the exporting country, sales in the exporting country do not permit a proper comparison with the

[171]In *US – Export Restraints*, the Panel ultimately found that Canada had not established the existence of a US measure requiring the treatment of export restraints as financial contributions in countervailing duty investigations and that the United States had therefore not violated Article 1 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). (Panel Report, *US – Export Restraints*, para 8.131). Before reaching this conclusion, the Panel did, however, conclude that an export restraint (defined by Canada for the purposes of the dispute as "a border measure that takes the form of a government law or regulation which expressly limits the quantity of exports or places explicit conditions on the circumstances under which exports are permitted") could not constitute a financial contribution under Article 1.1(a), more particularly government-entrusted or government-directed provision of goods under Article 1.1(a)(iv), since it did not involve "an explicit and affirmative action of delegation or command". (Panel Report, *US – Export Restraints*, paras. 8.44 and 8.75). In *US – Countervailing Measures* (*China*), in findings not appealed, the Panel found that the United States' initiation of two countervailing duty investigations in respect of certain export restraints was inconsistent with Article 11.3 of the SCM Agreement because of the absence of any information on how "the Government of China 'gives responsibility to' or 'exercises authority over' a private body in China specifically to carry out the function of providing magnesia and coke goods to domestic users." (Panel Report, *US – Countervailing Measures* (*China*), paras. 7.404 and 7.406). It is, however, worth noting that the Panel referred to the Appellate Body's finding in *US – Countervailing Duty Investigation on DRAMS* that the definition of "entrustment" and "direction" in *US – Export Restraints* was too narrow and instead applied the interpretation put forth by the Appellate Body that "the government gives responsibility to, or exercises its authority over, a private body to carry out one of the type of functions in (i) through (iii) of Article 1.1(a)(1)". (Panel Report, *US – Countervailing Measures* (*China*), para. 7.396 and 7.399 (referring to Appellate Body Report, *US – Countervailing Duty Investigation on DRAMS*, paras. 110–111)).

[172]Panel Report, *US – Countervailing Measures* (*China*), paras. 7.392–7.406.

export price.[173] Such a particular market situation is deemed to exist, among others, when "prices are artificially low".[174] This has led to imposition of anti-dumping duties where prices on inputs are kept low due to export restrictions.[175] In *EU – Biodiesel*, *EU – Cost Adjustment Methodologies* (*Russia*), and *EU – Biodiesel* (*Indonesia*), Argentina, Russia, and Indonesia, respectively, are challenging the Basic Anti-Dumping Regulation and administrative procedures, methodologies or practices calling for the rejection of actual cost data and the replacement with "market" cost data when constructing the "normal value".[176] These disputes may, therefore, shed light on the WTO consistency of such practices.

In a second category, Howse and Josling have proposed challenging the effect export restrictions may have on foreign providers of distribution services under the General Agreement on Trade in Services (GATS). These authors argue that export restrictions may violate the National Treatment obligation in Article XVII of the GATS when domestic service suppliers are primarily or exclusively distributing the good subject to export restrictions on the domestic market, while foreign service suppliers are primarily or exclusively distributing the good on the international market.[177] Such a challenge would, however, require that the Member imposing export restrictions has undertaken an obligation to fulfil the National Treatment obligation with regard to the specific distribution service involved.

While such approaches do not constitute a direct way of regulating or challenging export restrictions, they are interesting alternatives in the light of the lack of regulation of particularly export duties.

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[173]Council Regulation (EC) No 1225/2009 on protection against dumped imports from countries not members of the European Community, 30 November 2009, OJ 2009 L343/51, Article 2.3.

[174]Council Regulation (EC) No 1225/2009 on protection against dumped imports from countries not members of the European Community, 30 November 2009, OJ 2009 L343/51, Article 2.3.

[175]See, e.g. Council Regulation (EC) No 1256/2008 imposing a definitive anti-dumping duty on imports of certain welded tubes and pipes of iron or non-alloy steel, 16 December 2008, OJ 2008 L343/1, paras. 35 and 111.

[176]See Panel Requests, *EU – Biodiesel*, WT/DS473/5; *EU – Cost Adjustment Methodologies* (*Russia*), WT/DS474/4; and *EU – Biodiesel* (*Indonesia*), WT/DS480/2.

[177]Howse and Josling (2012), p. 21.

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Chapter 7
Reforming WTO Discipline on Export Duties: Sovereignty Over Natural Resources, Economic Development and Environmental Protection

Julia Ya Qin

Abstract The current WTO regime on export restraints comprises two extremes: at one end is the near complete freedom to levy export duties enjoyed by most Members, which renders the WTO discipline on export restrictions largely ineffective; at the other the rigid obligations imposed on several acceding Members prohibiting the use of export duties for any purpose. The recent WTO ruling in *China-Raw Materials* has only solidified the latter extreme. This article seeks to expose the irrationality of the current regime, especially the problems created by the rigid obligations of the several acceding Members. It contends that such obligations deprive these Members of their ownership right to claim a larger share of their natural resources for domestic use and of an effective tool for managing environmental externalities associated with the resource products exported. The virtual immutability of such obligations is at odds with the principle of permanent sovereignty over natural resources. To rectify these problems, the article proposes integrating all stand-alone export concessions into GATT schedules, which would provide the acceding Members with the policy space and flexibility available under the GATT. It is also submitted that the key to gaining support from developing countries for the establishment of a system-wide discipline lies in the recognition of legitimate functions of export duties. Rather than pushing for their elimination, the WTO should aim to regulate export duties in the same manner as its regulation of import duties.

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© Springer Japan 2016

M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_7

Keywords WTO • Export restrictions • Sovereignty • Natural resources • Economic development • Environment • Conservation • China • Raw materials • Rare earths

1 Introduction

The recent WTO dispute in *China-Raw Materials*[1] has exposed a highly irrational aspect of the world trade system. On the one hand, the WTO Agreement does not require its Members to limit the use of export duties, which renders its general discipline on export restrictions ineffective. On the other, China and a few other Members – all of which developing countries – are bound by the strictest obligations on export duties. Included as part of the terms of their accession to the WTO, these obligations are considered permanent, not amenable to change, and according to the rulings in *China-Raw Materials*, not entitled to any public policy exception if they do not explicitly refer to such exceptions contained in the General Agreement on Tariffs and Trade (GATT), the main WTO agreement regulating import and export tariffs.

The result is a highly imbalanced and inequitable state of affairs, especially insofar as trade in natural resources is concerned. At the one extreme, the absence of an effective WTO discipline on export restrictions leaves many economies, both developed and developing, vulnerable to shortage and price fluctuations in the supply of raw materials. In an era of globalized supply chains, the lack of security and stability in access to raw materials poses serious risks to numerous industries and businesses. At the other extreme, the "ironclad" discipline imposed on the selected acceding Members takes away permanently the right of these countries to use export duties as a legitimate tool for economic development, for they are not allowed to keep a greater share of their natural resources for domestic use, and must always sell their resource-based products to all domestic and foreign purchasers on an equal basis. Furthermore, should these countries fail to implement proper environmental standards in the production process, resulting in artificially low prices of raw materials, they may not use export taxes to address the negative environmental externality. If these countries choose to "subsidize" domestic industries with cheap raw materials, they are required by WTO law to do the same for competing foreign industries, even though they must ultimately bear the consequences of environmental degradation at home.

It should be obvious that such a state of affairs is undesirable and indefensible as a matter of principle for the WTO system, whose objectives include substantial reduction of tariffs, elimination of discriminatory treatment, and achieving the optimal use of world's resources and sustainable development through protecting and preserving the environment in a manner consistent with the respective needs and concerns of its Members at different levels of economic development.[2]

[1] *China–Measures Related to the Exportation of Various Raw Materials*, Appellate Body Reports, WT/DS394, 395, 398/AB/R, 30 January 2012 (AB Reports); Panel Reports, WT/DS394, 395, 398/R, 5 July 2011 (Panel Reports).

[2] The Agreement Establishing the World Trade Organization (WTO Agreement), Preamble.

The systemic issues underlying the WTO regime on export restrictions, however, did not attract much attention until more recently when global demand soared for natural resources and resource-based products.[3] The *China–Raw Materials* case, and the subsequent disputes over China's export restrictions on rare earths,[4] have pushed these issues to the forefront of WTO studies.[5]

This article seeks to accomplish two things: first, exposing the irrationality of the current WTO regime on export restrictions, especially the legal problems stemming from the ironclad rules imposed on the few acceding Members; second, proposing that all export duty obligations under the WTO be brought into the GATT framework as the first step towards rationalizing the regime. The rest of the article will proceed as follows. Part II explains the current WTO regime on export restraints and how it has resulted in four tiers of members in terms of their rights and obligations. Part III examines the functions of export duties and the implications of the current regime for sovereignty over natural resources, economic development and environmental protection. Part IV sets forth concrete proposals to rationalize the regime. Part V concludes.

2 The Irrational WTO Regime on Export Restraints

2.1 Curious Absence of GATT Discipline on Export Tariffs

Import and export restrictions are both barriers to trade. Hence, the world trade system set out to regulate both of them. The general scheme of the GATT is to eliminate all forms of import and export restrictions other than duties, taxes and other charges (Article XI), and to conduct tariff negotiations to reduce the general level of tariffs on both imports and exports by creating tariff bindings (Article XXVIII bis). In other words, GATT chose tariffs over quantitative restrictions as the lawful means of restricting imports and exports, and called for future negotiations to gradually reduce the level of both import and export tariffs. In addition, all import and export tariffs and charges must be applied on a nondiscriminatory basis (Article I), and be administered in a transparent and reasonable manner (Article X).

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[3]See World Trade Organization, World Trade Report 2010: Trade in Natural Resources (hereinafter, WTO Report on Resource Trade), available at www.wto.org. The report is the most comprehensive study on the subject to date.

[4]On March 13, 2012, the United States, the European Union and Japan launched formal WTO disputes over China's export restrictions on rare earths. *China–Measures Related to the Exportation of Rare Earths*, *Tungsten and Molybdenum* (*China–Rare Earths*), DS431(US), DS432 (EU), DS433 (Japan), at http://www.wto.org/english/news_e/news12_e/dsrfc_13mar12_e.htm.

[5]Recent studies include: Baris Karapinar, *Export Restrictions and the WTO Law*: *How to Reform the* '*Regulatory Deficiency*', 45(6) J. World Trade 1139 (2011); Mitsuo Matsushita, *Export Control of Natural Resources*: *WTO Panel Ruling on the Chinese Export Restrictions of Natural Resources*, 3 (2) Trade, Law & Dev. 267 (2011); Bin Gu, *Mineral Export Restraints and Sustainable Development – Are Rare Earths Testing the WTO*'*s Loopholes*? 14(4) J. Int'l Econ. Law 1 (2011).

The parallel between GATT regulations of import and export restrictions, however, does not go much further.[6] While GATT contains a detailed framework for binding import tariffs and for protecting the bindings from erosion, it sets out no specific obligation to bind export tariffs. In the ensuing decades, the world trading system has successfully concluded eight rounds of negotiations, leading to substantial reductions in tariff and nontariff barriers on imports. Yet, no similar negotiation has ever been conducted to reduce export tariffs and barriers. Other than the few exceptions discussed below, WTO Members remain free to levy duties on the export of any products. Because tariffs and quantitative restrictions are functionally the same in their effects on trade, Members can easily resort to tariffs to achieve the goal of export restriction. As a result, GATT Article XI discipline on export restrictions has largely been rendered ineffective.[7]

This curious loophole in the system is attributable to a number of factors. On the whole, the lack of focus on export restrictions reflects the mercantilist assumption among trading nations that exports are more desirable than imports.[8] The result is a system that is preoccupied with the access to markets (import restrictions), rather than the access to supply (export restrictions).[9] Historically, access to raw materials and other natural resource-based products did not pose a major problem. Many resource-exporting countries were economies that lacked industrial capacity and relied on selling primary commodities for income.[10] The main issues for them were unstable demand and price fluctuations in the commodity markets and the need to diversify their economies away from primary commodities.[11] When export restrictions were occasionally discussed during the GATT era, the contracting parties

[6]Other GATT provisions concerning export restrictions include Articles VII (customs valuation), VIII (fees and formalities), XIII (nondiscriminatory administration of quotas), XIV (exception to Article XIII), XVII (state trading), XX (general exceptions), XXI (security exceptions), and XXVIII (modification of schedules).

[7]An export duty set at a prohibitively high level would have the same effect as an export ban, hence might be challenged as such under GATT Article XI.

[8]Claude Barfield, *Trade and Raw Materials—Looking Ahead*, presentation at the Conference on the EU's Trade Policy and Raw Materials Brussels, September 29, 2008, at http://trade.ec.europa.eu/doclib/docs/2008/october/tradoc_140919.pdf.

[9]For a detailed discussion, see Melaku Geboye Desta, *The Organization of Petroleum Exporting Countries*, *the World Trade Organization*, *and Regional Trade Agreements*, 37(3) J. World Trade 523–551 (2003).

[10]Hence, historically the major industrial countries "could reasonably assume that no impediment would ever be placed to their free access to other people's resources." Statement of the Representative of Canada on February 22, 1977, GATT Doc. MTN/FR/W/6 (10 March 1977), p. 1. Credit is due to Lorand Bartels for pointing to this source.

[11]These issues were fully recognized at the inception of the GATT. See Havana Charter for an International Trade Organization, U.N. Doc. E/Conf. 2/78 (1948), Chapter VI. Inter-Governmental Commodity Agreements, Article 55 Difficulties relating to Primary Commodities. See also GATT Article XXIX (relation to the Havana Charter).

were unable to agree on how to approach the issue.[12] Some more advanced resource-exporting economies wanted to link negotiations over export restrictions to that over import restrictions affecting resource-based industrial products.[13] Others, representing the perspective of less developed economies, insisted that two of the guiding principles in reassessing the GATT export disciplines would be "the sovereignty of States over their natural resources" and "the need for developing countries to utilize their resources for their development in the most optimal manner as considered appropriate by them".[14]

In more recent years, global demand for resource products has outpaced supply, thanks in no small part to the rapid industrialization of developing economies, especially large countries such as China and India.[15] The rising demand in a world of finite supplies has caused widespread anxiety over the security in access to natural resources. Against this backdrop, the world has seen increasing uses of export restraints on resource products, mainly by developing countries.[16] In response, the European Union, the United States and several other WTO Members have circulated various proposals calling for reform of WTO rules on export restrictions.[17] Yet, such proposals have received "cool response" from developing country members.[18] With the collapse of the Doha Round, the prospect for negotiating a new multilateral discipline on trade in natural resources remains dim.

2.2 *Export Duty Commitments Under the WTO Agreement*

The lack of an effective GATT discipline on export restraints notwithstanding, a small number of WTO Members have made commitments on export duties. They

[12]The issue of export restrictions was discussed in both the Tokyo Round and the Uruguay Round with no result. See GATT Document, Export Restrictions and Charges, Background Note by the Secretariat, MTN/GNG/NG2/W/40 (8 August 1989).

[13]GATT, Communication from Delegation of Canada, MTN/FR/W/21 (30 March 1979); Statement by the Delegation of Australia, MTN/FR/W/22 (6 April 1979).

[14]GATT, Statement by the Delegation of India, MTN/FR/W/23 (6 April 1979).

[15]For trends in natural resource trade, see WTO Report on Resource Trade, supra note 3, at 54–59. Despite growing demand from China and India, developed countries remain as the leading importers of natural resources. As of 2008, the largest resource importers were the United States (15.2 %), Japan (9.1 %), China (8.6 %), Germany (6 %), South Korea (4.7 %), France (3.9 %) and India (3.5 %). Id., at 59.

[16]See WTO Report on Resource Trade, supra note 3, at 116–119.

[17]E.g., Communication from the European Communities, *Market Access for Non-Agricultural Products*: *Revised Submission on Export Taxes*, TN/MA/W/101 (17 January 2008); Communication from Chile; Costa Rica; Japan; Republic of Korea; the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu; Ukraine and the United States, *Market Access for Non-Agricultural Products*: *Enhanced Transparency in Export Licensing*, TN/MA/W/15/Add.4/Rev.7 (23 November 2010). See Karapinar, supra note 5, at 1149–50.

[18]Karapinar, id., at 1150.

fall under two categories: (1) commitments made under the GATT; and (2) commitments under the WTO accession protocols.

2.2.1 Export Duty Commitments Under the GATT

Despite the lack of a detailed framework for binding export duties, there were at least two known cases of export duty concessions in GATT history. The first was a concession on export duties on tin ore and tin concentrates, made in the early years of the GATT by the United Kingdom in respect of the Malayan Union.[19] The second is the concession made by Australia in the Uruguay Round in 1994. In exchange for certain import commitments from the European Communities, Australia agreed not to impose any export duty on certain iron ore, titanium ore, zirconium ore, coal, peat, coke, refined copper, unwrought nickel, nickel oxide, and lead waste and scrap.[20] In both cases, the concessions were set out in the tariff schedules annexed to the GATT.

2.2.2 Export-Duty Commitments Under Accession Protocols

After the establishment of the WTO, a number of acceding countries have been asked to undertake special commitments on export duties as part of the terms of their accession. Of the 29 countries that have acceded to the WTO (or have completed their accession negotiations) thus far, 9 have been required to do so. They are: Mongolia (1997), Latvia (1999), Croatia (2000), China (2001), Saudi Arabia (2005), Vietnam (2007), Ukraine (2008), Montenegro (2012) and Russia (2012).[21]

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[19] GATT Analytical Index, Article II, pp. 73–74 (citing the United Kingdom Schedule XIX, Section D (Malayan Union) to the effect that "The products comprised in the above item shall be assessed for duty on the basis of their tin content; the rate to be levied on such tin content being the same as the rate chargeable on smelted tin, *Provided* that the rate of duty on this item may exceed the rate chargeable on smelted tin in the event that and so long as the United States of America subsidised directly or indirectly the smelting of tin in the United States").

[20] Australia's Uruguay Round Goods Schedules, AUS1-201 through AUS1-204, available at http://www.wto.org/english/thewto_e/countries_e/australia_e.htm. Products subject to the export duty concessions are indicated with note (1), which states: "There shall be no export duty on this product. (EC)". The concessions were evidently made to the EC. By virtue of the most-favored-nation clause, they apply to all other WTO members as well. Special thanks to Amy Porges for identifying this information.

[21] At the time of this writing, the accessions of Montenegro and Russia have been approved by the WTO. They are expected to become WTO Members during the year of 2012, after the completion of relevant domestic ratification processes.

The scope and nature of the accession commitments on export duties vary widely.[22] At one end of the spectrum is Croatia, which merely promised to "apply export duties only in accordance with the provisions of the WTO Agreement".[23] Since the WTO Agreement does not contain any provision to limit the use of export duties, this commitment amounts to nothing substantive. At the other end is Montenegro, which has promised not to apply or reintroduce any export duties.[24] Close to this end is China, which made a sweeping commitment to "eliminate all taxes and charges applied to exports" except for 84 products, and to bind the export duties on all 84 products at specific rates.[25] Similarly, Latvia undertook to abolish all export duties on products listed in its accession protocol (which are certain wood products, metal scraps and antiques) except for specific antiques.[26] The other countries agreed to eliminate or reduce export duties on specific products only. Thus, Mongolia agreed to eliminate, within 10 years of its accession, export duties on raw cashmere.[27] Saudi Arabia undertook not to impose any export duty on iron and steel scrap.[28] Vietnam promised to gradually reduce the rates of export duties on a number of ferrous and non-ferrous scrap metals.[29] And Ukraine committed to reduce and bind the rates of export duties in accordance with a detailed schedule on a variety of oil seeds, live cattle and hides, and ferrous and non-ferrous scraps.[30] The most extensive product-specific commitments have been made by Russia, which has agreed to bind export duties on more than 700 tariff lines.[31]

[22]The accession packages of the acceding countries are available at http://www.wto.org/english/thewto_e/acc_e/acc_e.htm.

[23]Report of the Working Party on the Accession of Croatia to the World Trade Organization, WT/ACC/HRV/59 (29 June 2000), para. 101. Croatia confirmed that it did not impose any export duty at the time, but its government retained authority to impose export duties "in exceptional cases for the protection of exhaustible natural resources, or to ensure essential materials to the domestic industry and to prevent shortages in domestic supply." Id., para. 100. Paragraph 100, however, is not legally binding as it was not incorporated into the accession protocol of Croatia. See id., para. 225.

[24]Report of the Working Party on the Accession of Montenegro to the World Trade Organization, WT/ACC/CGR/38 (5 December 2011), para. 132.

[25]Protocol on the Accession of the People's Republic of China, WT/L/432 (10 November 2001), para. 11.3; Annex 6.

[26]Report of the Working Party on the Accession of Latvia to the World Trade Organization, WT/ACC/LVA/32 (30 September 1998), para. 69; Annex 3.

[27]Report of the Working Party on the Accession of Mongolia, WT/ACC/MGN/9 (27 June 1996), para. 24.

[28]Report of the Working Party on the Accession of the Kingdom of Saudi Arabia to the World Trade Organization, WT/ACC/SAU/61 (1 November 2005), para. 184.

[29]Report of the Working Party on the Accession of Viet Nam, WT/ACC/VNM/48 (27 October 2006), para. 260 and Table 17. Viet Nam provided a list of 43 products subject to export duties, but stated that it did not consider the imposition of export duties are inconsistent with WTO rules. Id., para. 257 and Table 16.

[30]Report of the Working Party on the Accession of Ukraine to the World Trade Organization, WT/ACC/UKR/152 (25 January 2008), para. 240, and Table 20(b).

[31]See infra text at note 58.

The commitments of the acceding countries are set out in their respective protocols of accession. Pursuant to Article XII of the WTO Agreement, a country may accede to the WTO Agreement "on terms to be agreed between it and the WTO". Because the acceding Member will benefit from the access to the markets of other WTO Members that were liberalized through previous negotiation rounds, it is expected to reciprocate by opening up its own market. Thus, the terms to be negotiated in accession focus heavily on market access, i.e., reduction in tariff and non-tariff barriers on imports, in the acceding country. However, since Article XII does not place any limit on the "terms" to be negotiated, the WTO has developed a practice of demanding concessions from the acceding country that go well beyond market access. The result is a whole slew of member-specific obligations, ranging from those of commercial in nature, such as export duty commitments, to those that would require systemic reforms at home.[32] These obligations are known as "WTO-plus", for they exceed the requirements of the multilateral WTO agreements. The country subject to the largest number of WTO-plus obligations is China.[33]

The member-specific obligations of the acceding Members are enforceable under WTO law, as each of the protocols of accession declares itself as "an integral part" of the WTO Agreement, which is a "covered agreement" for the purpose of WTO dispute settlement.[34] Apart from enforceability, however, it remains unclear how exactly the member-specific obligations are "integrated" into the WTO Agreement.

2.2.3 Legal Issues Raised by the Stand-Alone Export Duty Commitments

The export duty commitments undertaken in the accession protocols raise at least two major issues in WTO law: (a) whether these commitments are entitled to the general exceptions available under the GATT; and (b) whether these commitments can ever be modified or withdrawn.

(a) Availability of GATT Exceptions to Export Duty Commitments

Whether a member-specific commitment under the accession protocol is entitled to the policy exceptions provided for in the relevant WTO agreements, such as GATT Articles XX (general exceptions) and XXI (security exceptions), raises a systemic question on the relationship between different legal instruments within the

[32] For a general survey and analysis of such obligations within the WTO system, see Steve Charnovitz, *Mapping the Law of WTO Accession*, in Merit E. Janow, Victoria Donaldson & Alan Yanovich (eds.), The WTO: Governance, Dispute Settlement & Developing Countries (Juris Publishing, 2008), Chap. 46.

[33] See generally Julia Ya Qin, "*WTO-Plus*" *Obligations and Their Implications for the WTO Legal System – An Appraisal of the China Accession Protocol*, 37(3) J. World Trade 483 (2003).

[34] See e.g., China's Accession Protocol, Paragraph 1.2.

framework of the WTO Agreement.[35] Insofar as China's accession protocol is concerned, the Appellate Body has taken a strict textualist approach, according to which the applicability of GATT general exceptions to a particular accession commitment hinges on whether there is an explicit textual link between them. Thus, in *China–Publications*, the Appellate Body held that China may invoke GATT Article XX to defend the violation of its trading-rights commitments set out in paragraph 5.1 of China's accession protocol, because the introductory phrase of paragraph 5.1 provides such a textual link (stating that the trading-rights commitments are "without prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement").[36] By contrast, in *China–Raw Materials*, the Appellate Body rejected the applicability of GATT Article XX to China's export duty commitments, because it could not find a similar textual link in paragraph 11.3 of its accession protocol.[37] "In the light of China's explicit commitment contained in Paragraph 11.3 to eliminate export duties and the lack of any textual reference to Article XX of the GATT 1994 in that provision," the Appellate Body concludes, "we see no basis to find that Article XX of the GATT 1994 is applicable to export duties found to be inconsistent with Paragraph 11.3."[38]

The Appellate Body's ruling has serious implications not only for China, but also for other acceding Members that have undertaken export duty commitments. Of these Members, Mongolia, Latvia, Saudi Arabia and Montenegro all undertook to eliminate export duties on all or specific products, but none of them included in their commitments an express reference to the GATT exceptions. Consequently, none of these countries will be entitled to invoke the policy exceptions of GATT Articles XX and XXI to justify a departure from such commitments. By contrast, Vietnam, Ukraine and Russia did include an express reference to GATT in the text

[35]For historical reasons, the WTO treaty structure is exceedingly complex and the relationship between provisions of different WTO agreements is not always explained in the treaty language. It remains unclear, for example, whether the GATT general exceptions should apply to the various other WTO agreements on trade in goods, such as the agreements on antidumping measures and subsidies. When this question arose in disputes, the Appellate Body avoided answering it directly. See Appellate Body Reports, *United States–Measures Relating to Shrimp from Thailand* (DS343), *United States–Customs Bond Directive for Merchandise Subject to Antidumping/Countervailing Duties* (DS345), WT/DS343/AB/R, WT/DS345/AB/R, adopted 1 August 2008, paras. 304–319.

[36]Appellate Body Report, *China–Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R (21 December 2009), paras. 229–233.

[37]AB Reports, para. 291. It also attaches significance to the fact that Paragraph 11.3 expressly refers to GATT Article VIII but not other GATT provisions. Id., para. 303.

[38]Id., para. 306.

of their respective export duty commitments.[39] Rather than eliminating export duties, these three countries agreed to bind export duties on specific products only.[40] It is also worth noting that all three countries have concluded their accession packages after the issue of legal justification arose with respect to China's export duty commitments.[41]

The strict textualist approach taken by the Appellate Body, regrettably, has led to an irrational and undesirable result in the WTO system. The general exceptions of GATT Articles XX and XXI are designed to safeguard important public policies and non-trade values from being infringed by the obligations to liberalize trade. They apply to all GATT obligations, ranging from tariff concessions, to the elimination of all quantitative restrictions, to the fundamental principles of most-favored-nation (MFN) treatment and national treatment. By holding the export duty commitments immune from the GATT policy exceptions, the Appellate Body has effectively turned these trade-liberalization commitments into more "sacred" obligations than the most fundamental principles of the WTO. From a policy standpoint, the Appellate Body's ruling sends a powerful message: without an express textual reference, individual trade-liberalization obligations will be interpreted to trump public policy and nontrade values under WTO law.

The Appellate Body's decision indicates that it views each accession protocol as a self-contained agreement, independent from the rest of the WTO Agreement, and that the relationship between a specific accession commitment and another WTO agreement can only be established through an express reference in the text of that specific accession commitment. This view, however, is highly problematic.[42] Unlike other legal instruments annexed to the WTO Agreement, WTO accession protocols are not devoted to a single subject matter, such as trade in goods, services,

[39]Vietnam's commitment provides that "Viet Nam would apply export duties, export fees and charges, as well as internal regulations and taxes applied on or in connection with exportation in conformity with the GATT 1994." Report of the Working Party on the Accession of Viet Nam, supra note 29, para. 260. Ukraine's accession protocol states that, with respect to the products subject to the export duty commitments, "Ukraine would not increase export duties, nor apply other measures having an equivalent effect, unless justified under the exceptions of the GATT 1994." Report of the Working Party on the Accession of Ukraine, supra note 30, para. 240. For the Russia case, see Part II.B.4.

[40]See Appendix.

[41]The EU, the United States and Japan had raised the issue with China on the legal justification for its export duties on raw materials long before the *China–Raw Materials* case was initiated. See e.g., WTO Transitional Review Mechanism Pursuant to Paragraph 18 of the Protocol on the Accession of the People's Republic of China, *Questions from the European Communities to China*, G/C/W/538 (8 November 2005); *Questions from the United States to China*, G/C/W/560 (6 November 2006); *Questions from the European Communities to China*, G/C/W/568 (17 November 2006); *Questions from Japan to China*, G/C/W/586 (2 November 2007). Hence, the issue had become known by the time Vietnam, Ukraine and Russia finalized their accession packages in 2006, 2008 and 2011, respectively,

[42]For a more detailed critique, see Julia Ya Qin, *The Predicament of China's "WTO-Plus" Obligation to Eliminate Export Duties*: *A Commentary on the China-Raw Materials Case*, 11(2) Chinese J. Int'l Law 237 (2012).

investment measures or intellectual property rights. Instead, the accession protocol sets out the terms of accession for a country that cover subjects across the entire spectrum of the WTO Agreement. Consequently, the special commitments of the acceding country cannot be understood independently of the general disciplines set out in the multilateral WTO agreements. The export duty commitments are such an example – they are inherently related to GATT disciplines on customs tariffs and export restrictions. A sensible interpretive approach, therefore, should treat these GATT provisions, as well as the policy exceptions available to them, as part of the relevant treaty context for the export duty commitments.[43]

Key to the narrow textualist approach of the WTO judiciary is an assumption that each term of the accession protocol was carefully negotiated and drafted, and that any omission of an explicit reference to another WTO agreement was a "deliberate choice" by the parties.[44] Thus, the Appellate Body considered it "reasonable to assume that, had there been a common intention to provide access to GATT Article XX in this respect, language to that effect would have been included in Paragraph 11.3 or elsewhere in China's Accession Protocol."[45] This "reasonable" assumption, however, disregards the political reality of accession negotiations. Unlike WTO multilateral negotiations, in which diverse interests among Members can be expected to provide the checks and balances necessary to produce carefully-drafted rules, WTO accession is a process in which the applicant country must negotiate against the entire incumbent membership, through both bilateral and multilateral procedures.[46] In such a process, whether a particular term was well negotiated and carefully drafted would depend not only on the bargaining power of the applicant in specific negotiations, but also on the level of legal sophistication and competence of its negotiation team and the quality of its domestic decision-making process. Given the typical lack of experience on the part of the acceding country, it is common to see loosely drafted terms of accession.[47]

(b) Non-adjustability of Export Duty Commitments

Another major issue arising from the export duty commitments undertaken under the accessions is the lack of flexibility of these commitments. None of the existing WTO accession protocols mentions the possibility of amendment. Hence, whether an accession protocol is amendable, and if so how it should be amended,

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[43]For a systemic treatment of the topic, see Julia Ya Qin, *The Challenge of Interpreting* "*WTO-Plus*" *Provisions*, 44(1) J. World Trade 127 (2010). For an excellent critique of the narrow textualist approach adopted by the Appellate Body, see Henrik Horn and Joseph Weiler, *European Communities–Trade Description of Sardines*: *Textualism and Its Discontent*, in H. Horn and P. Mavroidis (eds.), The WTO Case Law of 2002 (Cambridge U. Press 2005), 248.

[44]Panel Reports, para. 7.129.

[45]AB Reports, para. 293.

[46]The problem of political imbalance in WTO accession negotiations is well known. See e.g., Kent Jones, *The Political Economy of WTO Accession*: *the Unfinished Business of Universal Membership*. 8(2) World Trade Rev. 279–314 (April 2009).

[47]See Qin, supra note 33, 515–16, for examples in China's accession protocol.

remain unclear as a matter of WTO law. One view holds that the terms of accession are pre-conditions for the WTO membership of the acceding country and as such cannot be renegotiated once the accession is completed. According to this view, all accession terms are permanent and immutable, except for the market access commitments incorporated into the schedules of GATT and the General Agreement on Trade in Services (GATS), which can be adjusted according to the GATT and GATS procedures respectively. The only way the acceding country can escape the terms of its accession is to withdraw from the WTO altogether.

An alternative view sees the terms of accession as supplemental to the multilateral WTO agreements, and as such superseding inconsistent WTO provisions when applied to the acceding country. In accordance with this view, the member-specific commitments contained in the accession protocol are integrated organically into the WTO rule system and can be amended in the same way as other provisions of the WTO Agreement. Given the extreme difficulty in amending a WTO provision,[48] however, revising the terms of accession is practically impossible. In theory, the WTO can also adopt a separate procedure for the amendment of accession protocols,[49] but in practice it is doubtful that any acceding country would be willing and able to engage the WTO membership in the negotiation of this issue. As a result, the terms of accession are fixed without a realistic chance for revision.

In the context of the export duty commitments, this inflexibility contrasts sharply with the ample opportunities for adjustment of import duty concessions of an acceding country. By virtue of being formally incorporated into the GATT, the tariff bindings of the acceding Member can be renegotiated in accordance with a number of GATT provisions, including Article XXVIII (modification of schedules), Article XVIII:7 (promoting infant industries by developing countries), Article XXIV:6 (formation of a customs union), and Article II:6 (adjustment of specific duties due to currency revaluation). The principal provision for tariff renegotiation is Article XXVIII. Under this provision, a WTO Member may modify or withdraw a concession included in its GATT schedule by entering into agreement with Members with which the concession "was initially negotiated" and other Members that have "a principal supplying interest", subject to consultation with any other Member determined by the WTO to have "a substantial interest" in the concession.[50] Such modification or withdrawal can be done every three years ("open season"

[48]Pursuant to Article X of the WTO Agreement, any amendment that would alter the rights and obligations of the Members shall take effect upon acceptance by two thirds of the Members. Because "acceptance" means that the Members must comply with their respective domestic legal procedures for approval of a treaty amendment, which for some Members would require ratification by legislature, amendment to a WTO provision is extremely difficult. To date, the only formal amendment to an annex of the WTO Agreement that has been adopted by the General Council is the 2005 amendment to the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Amendment of TRIPS Agreement, WT/L/641 (8 Dec. 2005). This amendment has not yet taken effect because it has not received acceptance by two thirds of the Members.

[49]See Qin, supra note 43, 134–35.

[50]GATT Article XXVIII:1; Ad Article XXVIII.

renegotiation).[51] The Member seeking modification is expected to offer compensatory adjustment so as to maintain a general level of reciprocal concessions not less favorable to trade than that provided for prior to the renegotiation. However, if no agreement can be reached, the Member is nonetheless free to modify or withdraw the concession, in which case other interested Members will be free to withdraw substantially equivalent concessions.[52] In addition to the open season, the WTO may, at any time in special circumstances, authorize a Member to enter into negotiations for modification or withdrawal of a scheduled concession, subject to specific procedures and conditions.[53] All modifications and withdrawals shall be applied on an MFN basis to all Members of the WTO.

The right of a Member to modify or withdraw a concession is absolute, in that it is not dependent on an agreement being reached with other Members.[54] In practice, dozens of Members, including all major trading nations, have invoked the right to modify their concessions under Article XXVIII.[55] Tariff concessions are modified or withdrawn under Article XXVIII generally to afford additional protection to industry or agriculture.[56] A similar right is provided for the modification and withdrawal of services concessions under the GATS.[57]

The flexibility built into the GATT and GATS schedules is ultimately beneficial for trade liberalization. Knowing that a concession may be withdrawn if necessary, WTO Members are more inclined to make new concessions. This rational aspect of the system, however, is completely lost in the case of the stand-alone export duty commitments under the accession protocols.

[51]The first 3-year period began on 1 January 1958, and the latest one on 1 January 2012. Pursuant to Article XXVIII:5, a Member may, by advance notice to the WTO, reserve the right to renegotiate its concessions throughout the duration of the next 3-year period.

[52]GATT Article XXVIII:3.

[53]GATT Article XXVIII:4. In GATT practice, approval of request for authorization under Article XXVIII:4 had become a routine matter. Anwarul Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO, Procedures and Practices (Cambridge U. Press, 2001), 88.

[54]Hoda, id., at 16. Although in such cases other Members may retaliate by withdrawing substantially equivalent concessions, such retaliation has been rare in practice. The rare use can be ascribed to the fact that renegotiations were generally successful and that the retaliatory withdrawals must be made on an MFN basis. See Hoda, id., at 95–97.

[55]During the GATT era (until 30 March 1994), more than 40 members made a total of 270 requests to modify their concessions, and each such request may range from one tariff item to an entire schedule. See GATT Analytical Index, Article XXVIII, Tables. Since the establishment of the WTO in 1995, there have been 34 requests to enter into renegotiations under GATT Article XXVIII. See WTO: Goods Schedules–Current Situation of Schedules, at www.wto.org/english/tratop_e/schedules_e/goods_schedules_table_e.htm.

[56]Hoda, supra note 53, at 91, 107. Other common reasons were rationalization or simplification of tariffs, introduction of new tariff nomenclature and conversion from specific to ad valorem tariffs.

[57]GATS Article XXI (Modification of Schedules).

2.2.4 The Russia Model

The Russian accession has broken new ground in the legal treatment of export duty commitments. Unlike other acceding countries, Russia has successfully negotiated its export duty commitments within the GATT framework, thus avoiding the issues arising from the stand-alone commitments discussed above.

Specifically, Russia has created a new "Part V–Export Duties" in its GATT Schedule,[58] detailing products of more than 700 tariff lines that are subject to the maximum rate of export duties ranging from 0 % to 50 % or to specific duties determined by complex formulae. According to the Working Party Report on Russia's accession, Russia will implement, from the date of accession, its tariff concessions and commitments contained in Part V of its schedule, "subject to the terms, conditions or qualifications" set forth therein.[59] Part V of the Russia Schedule begins with this statement:

> The Russian Federation undertakes not to increase export duties, or to reduce or to eliminate them, in accordance with the following schedule, and not to reintroduce or increase them beyond the levels indicated in this schedule, *except in accordance with the provisions with GATT 1994*. (emphasis added)

Thus, Russia has explicitly reserved the right to (i) invoke all applicable GATT exceptions with respect to its export duty concessions, and (ii) amend Part V of its schedule in accordance with applicable GATT provisions.

A question remains as to whether Article XXVIII, the principal GATT provision on the modification of schedules,[60] applies to Part V of the Russia Schedule. Article XXVIII clearly contemplates modification of import concessions, as it refers to the Members with "a principal supplying interest" in a concession (along with the Members with which a concession was "initially negotiated" and those "with a substantial interest" in the concession).[61] It is noteworthy that Part V of the Russia Schedule does not include a column indicating which Members will have "initial negotiating rights" (INR) in the event of renegotiation of a specific concession according to Article XXVIII.[62] However, INR is not indicated in all import concessions,[63] and the absence of INR does not affect the absolute right of a Member to modify or withdraw its concessions under Article XXVIII.[64] The Article, which is titled "Modification of Schedules", applies to "a concession" that is "included in the appropriate Schedule annexed to this [GATT]

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[58]GATT Schedule CLXV – The Russian Federation (the Russia Schedule).

[59]The Report of Working Party on the Accession of the Russian Federation to the World Trade Organization, WT/ACC/RUS/70 (17 November 2011), para. 638.

[60]Supra text at notes 51–53.

[61]Supra text at note 50.

[62]A column of INR is included in the part for import tariff concessions of the Russia Schedule. See the Russia Schedule, Part I.

[63]See Hoda, supra note 53, at 12–13.

[64]Supra text at note 54.

Agreement".[65] Part V of the Russia Schedule clearly falls within this definition. Other than the references to "a principal supplying interest", the mechanism set out in Article XXVIII can be used for both import and export concessions.[66] The focus on the renegotiation of import concessions in this Article is indicative of the historical fact that export concessions were not being negotiated at the time; but it does not necessarily mean that the drafters intended to exclude export concessions from the coverage of Article XXVIII.[67] As noted above, the GATT set out to regulate both import and export restrictions. And Article XXVIII bis (*Tariff Negotiations*) specifically recognizes the importance of conducting negotiations "directed to the substantial reduction of the general level of tariffs and other charges on imports and exports".[68] Thus, from a systemic perspective, the principle and rationale underlying Article XXVIII should be equally valid and applicable to export concessions. It remains to be seen, however, whether this understanding will be contested.

2.3 The Four Tiers of WTO Members

As a result of the varying arrangements, there are now effectively four tiers of WTO Members in terms of their rights and obligations concerning export restraints. The first tier, which currently counts more than 140 Members, enjoys nearly complete freedom to restrict exports, so long as the restriction is in the form of export duty or taxes.[69] The second tier, consisting of Australia and Russia, has the obligation not to levy export duties on specific products in excess of those set forth in their respective GATT schedules, but retains the full range of rights under the GATT with respect to their commitments. The third tier comprises Ukraine and Vietnam, which have the obligation to bind export tariffs under their respective accession protocols, but may invoke GATT exceptions to justify a breach of such obligation. The fourth tier consists of Mongolia, Latvia, China, Saudi Arabia, and Montenegro. These countries have the obligation to eliminate the use of export tariffs under their

[65] Article XXVIII:1.

[66] In the context of export concessions, the equivalent to the concept of "a principal supplying interest" would be "a principal purchasing interest".

[67] A parallel argument was made by Matsushita with respect to the question of whether export duty concessions are within the scope of GATT Article II:1. See Matsushita, supra note 5, at 274.

[68] GATT Article XXVIII bis, paragraph 1.

[69] A Member's ability to apply export taxes may be subject to domestic constraints. The United States, for example, may not levy taxes on exports under its Constitution. See U.S. Constitution, art. 1, sec. 9, cl. 5 ("No tax or duty shall be laid on articles exported from any state."). The provision originated in the concern of the southern states, whose economies relied heavily on exports, that the new Federal government would be able to tax their exports in favor of the states that did not export. For detailed treatment of the topic, see Eric Jensen, *The Export Clause*, 6 Florida Tax Review 1 (2003).

respective accession protocols, but may not invoke GATT exceptions to justify a departure from such obligation. Neither the third-tier or fourth-tier Members have the right to modify or withdraw their export duty concessions. The situation of the four tiers of WTO Members is summarized in Appendix.

The four-tier membership creates unequal rights and obligations among Members. While the scope of trade-liberalization commitments may vary from country to country, the rights of WTO Members to invoke public policy exceptions and to modify their commitments according to certain procedures should be kept uniform as a matter of principle. The current irrational state of affairs results from the ad hoc rulemaking in the WTO accession regime. Regrettably, the WTO judiciary is apparently unable and unwilling to mitigate the situation.[70]

3 Policy Implications of the WTO Export-Duty Regime

3.1 The Role of Export Duties

Historically, countries have applied export duties for a variety of reasons. Besides generating revenue for the government, export duties can be used to smooth out the volatility of export earnings, to soften the impact of rapidly rising world prices in the domestic market, to counter escalating tariffs in importing countries, and to promote a fairer distribution of income by taxing the windfall gains of exporters.[71] In the case where a country controls a large share of the world supply of a particular material, the levy of export duties can raise the price of the material in international markets, thereby improving the terms of trade for the country.[72]

In addition, export duties may be used to pursue policy objectives that cannot be pursued under WTO law by nontariff means. In particular, the freedom to levy export duties allows a country to promote domestic downstream industries, and to conserve exhaustible natural resources and protect the environment in a manner inconsistent with the requirements of GATT Article XX. The legitimacy of these functions is discussed below.

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[70]See supra text at note 43.

[71]WTO Report on Resource Trade, supra note 3, at 127.

[72]The terms of trade refers to the relative price on world markets of a country's exports as compared to its imports. In the case of resource trade, a relatively small number of countries endowed with scarce resources may be able to maximize their national economic welfare by limiting the supply to the rest of the world. When this happens, the terms of trade and economic welfare of the importing countries will worsen by the same amount. Hence, an export tax motivated by this purpose is referred to as a "beggar-thy-neighbor" policy. See WTO Report on Resource Trade, supra note 3, at 12.

3.2 Export Duties and Economic Development

Export duties tend to lower the domestic prices of raw materials and raise their foreign prices. Hence, a country can use export duties to promote and protect its domestic industries utilizing the raw materials. For developing countries, especially those that are overly dependent on the export of primary commodities, promoting domestic processing and downstream industries can be an effective way to diversify their economies and to "climb up the value chain". It is for this reason that many developing countries regard export tariffs as a legitimate tool for economic development.[73]

The legitimacy of export duties as a tool for economic development stems ultimately from the principle of sovereignty over natural resources. Accordingly, the discussion on export restraints and economic development ought to begin with an exploration of this principle.

3.2.1 The Sovereign Right to Use Natural Resources for Economic Development

A nation's right to use and exploit its natural resources for economic development is implicit in its sovereignty over natural resources. As acknowledged by the Panel in *China-Raw Materials*, state sovereignty over natural resources is a principle of international law that allows states to "freely use and exploit their natural wealth and resources wherever deemed desirable by them for their own progress and economic development".[74]

In exercising its sovereign right to natural resources, a nation may wish to reserve a larger share of such resources for use by its domestic industries, rather than to sell them to foreign users. Because manufactured products are typically more valuable than primary commodities, developing downstream industries can help an economy to move away from reliance on exports of resources and build up high value-added sectors as its anchor. History has shown that export restraints on raw materials are an effective means of promoting economic development. One of the well-known historical examples is the export ban imposed by Henry VII on English wool in the late fifteenth century, which induced a shift of wool textile production from Flanders and Burgundy to England, thus enabling the start of the industrial revolution.[75] Today, such a policy would be condemned for its "beggar-thy-neighbor" effect. There is, however, an important distinction between import

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[73]WTO Report on Resource Trade, supra note 3, at 184.

[74]Panel Reports, para. 7.380, quoting U.N.G.A. Resolution 626 (VII), *Right to Exploit Freely Natural Wealth and Resources* (21 December 1952).

[75]Clyde V. Prestowitz, *Export Restraints*: *The Key to Getting Rich*, Foreign Policy Magazine, July 7, 2011. Ha-Joon Chang, Kicking Away the Ladder: Development Strategy in Historical Perspective (Anthem Press, 2002), 19–21.

restrictions used to "beggar thy neighbors" and export restraints on resource materials: the latter is a policy designed to take advantage of one's natural endowment, in the exercise of one's ownership rights.

The subject of sovereignty and trade is discussed extensively in legal scholarship. Responding to new issues of globalization, recent studies tend to focus on changes in the State's power to control and regulate domestic activities affecting trade.[76] The topic of sovereignty over natural resources is rarely discussed in such a context. Notably, the WTO's World Trade Report 2010 did cover the topic, but dealt with it as an issue more relevant to foreign investment law than WTO law.[77] In *China-Raw Materials*, China argued that the GATT exception for the conservation of exhaustible natural resources should be interpreted in a manner that recognizes a Member's sovereign rights over natural resources.[78] That argument, however, was dismissed by the Panel with a brief statement that "Members must exercise their sovereignty over natural resources consistently with their WTO obligations".[79] Consequently, the broad implications of the sovereign right over natural resources for WTO law have been left unaddressed.

The concept of "permanent sovereignty over natural resources" evolved as a new principle of international law in the post-war era within the United Nations.[80] Initially, the claims were motivated by the efforts of newly independent and other developing nations to secure the economic benefits arising from the exploitation of natural resources within their territories. In the decolonization period, the principle became associated with the right of colonial peoples to self-determination and with human rights. Subsequently, the emphasis on the purpose of the principle was placed on promoting national economic development. As declared by the famed UN Declaration on Permanent Sovereignty Over Natural Resources: "The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned."[81]

One distinct attribute of the sovereign right to natural resources is its status as a basic human right under international law. According to the two Covenants on Human Rights (International Covenant on Civil and Political Rights, and the

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[76]See e.g., John H. Jackson, Sovereignty, the WTO and Changing Fundamentals of International Law (Cambridge U. Press, 2006). For a collection of essays written by prominent authors, see Shan, Simon and Singh (eds.), Redefining Sovereignty in International Economic Law (Hart Publishing, 2008).

[77]Supra note 3, at 177–179 (noting that there is no provision in the WTO that speaks directly to the issues of ownership of natural resources or the allocation of natural resources between states and foreign investors).

[78]Panel Reports, para. 7.364.

[79]Id., para. 7.381. The Panel also reasoned that the ability to enter into the WTO Agreement is a "quintessential example of the exercise of sovereignty". Id., para. 7.382.

[80]For a comprehensive treatment, including the history of the principle, see Nico Schrijver, Sovereignty over Natural Resources: Balancing Rights and Duties (Cambridge U. Press, 1997).

[81]UN General Assembly Resolution 1803(XVII) of 14 December 1962, para. 1.

International Covenant on Economic, Social and Cultural Rights): "All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law."[82] "Nothing" in the two Covenants "shall be interpreted as impairing the inherent right of all peoples to enjoy and utilize fully and freely their natural wealth and resources".[83] Furthermore, the United Nations also recognizes "the right to development" as "an inalienable human right", and that the realization of such right requires "the exercise of their inalienable right to full sovereignty over all their natural wealth and resources".[84] The notion that the sovereign right to natural resources belongs to peoples – hence a human right – is an exceedingly powerful one. It suggests that the State is merely the representative of its citizens in exercising this right, and that the State has the duty to exercise such right diligently and in the best interest of its population.

Another distinct feature of the sovereignty over natural resources is its "permanency". The permanent character implies that the right to dispose freely of natural resources can always be regained, notwithstanding contractual obligations to the contrary.[85] A State can and should regain this right if due to changed circumstances its contractual obligations have become so onerous that they were manifestly against the interest of its people.[86] As Abi-Saab, a former member of the Appellate Body, once put it, "sovereignty is the rule and can be exercised at any time" and "limitations are the exceptions and cannot be permanent, but limited in scope and time."[87]

Clearly, the sovereign rights over natural resources are granted to peoples on the basis of territorial sovereignty rather than a principle of sharing the world's resources.[88] Since natural resources are unevenly distributed geographically, the notion of permanent sovereignty solidifies the unequal situations between nations that are rich in natural endowment and those that are not. Although in modern

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[82]International Covenant on Civil and Political Rights, 999 UNTS 171 (16 December 1966), art. 1.2; International Covenant on Economic, Social and Cultural Rights, 993 UNTS 3 (16 December 1966), art. 1.2.

[83]International Covenant on Civil and Political Rights, art. 47; International Covenant on Economic, Social and Cultural Rights, art. 25.

[84]United Nations General Assembly, *Declaration on the Right to Development*, UNGA Resolution 41/28 (4 December 1986), Article 1.

[85]See Schrijver, supra note 80, at 263.

[86]Id., at 264 (concluding that "it is now commonly accepted that the principle of permanent sovereignty precludes a State from derogating from the essence of the exercise of its sovereign rights over natural resources", but a State may by agreement freely entered into accept "a partial limitation on the exercise of its sovereignty in respect of certain resources in particular areas for a specified and limited period of time").

[87]Id., at 263 (quoting Abi-Saab, *Progressive Development of the Principles and Norms of International Law Relating to the New International Economic Order*, in UN Doc. A/39/504/ Add.1, 23 October 1984).

[88]Id., at 386.

international law the States also have a duty to cooperate with each other and to promote international development, so far “it has proven to be impossible to share the benefits of natural-resources exploitation on an international basis”.[89] Issues involving the exploitation and disposal of natural resources tend to evoke strong emotions, especially in developing countries with a colonial past. People tend to instinctively view such issues as a matter of national sovereignty, and are particularly jealous of their rights as the owner of their natural wealth.

3.2.2 WTO Constraints on the Sovereign Right to Dispose Freely of Natural Resources

A nation’s claim to a larger share in the distribution of its natural resources, however, is subject to the international obligations it voluntarily undertakes.[90] By entering into the WTO Agreement, a sovereign nation accepts the limitations imposed by the WTO on the exercise of its right to the free disposal of its natural resources. The most significant of such limitations is GATT Article XI:1, which prohibits a Member from using any quantitative or other nontariff means to restrict exports.[91] While this prohibition is subject to various exceptions, none of the exceptions can be used for the purpose of promoting domestic industries.

Specifically, Articles XI:2(a) and (b) allow the imposition of export restrictions “temporarily applied” to relieve critical shortages of foodstuffs or other essential products, or necessary to the application of standards or regulations for the classification, grading or marketing of commodities. Articles XX(g), (h), (i) and (j) authorize the adoption of measures “relating to the conservation of exhaustible natural resources if such measure are made effective in conjunction with restrictions on domestic production or consumption”; or measures “undertaken in pursuance of obligations under any intergovernmental commodity agreement”; or restrictions on exports of domestic materials necessary to ensure essential quantities of such 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”, provided that “such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry”; or measures “essential to the acquisition or distribution of products in general or local short supply”, provided that any such measures shall be consistent with the principle that all Members “are entitled to an equitable share of the international supply of

[89] Id.

[90] In a globalized economy, a State’s right to freely dispose of its natural resources is constrained by a growing body of complex rules governing global economic relations. For specific constraints on sovereign rights over natural resources, see Schrijver, supra note 80, at 306–395.

[91] The Article XI prohibition applies to a natural resource only to the extent that it may be traded. It is generally accepted that WTO rules generally do not regulate natural resources before they are extracted or harvested. Accordingly, restrictions on production of resources are not considered to be inconsistent with Article XI. See WTO Report on Resource Trade, supra note 3, at 162.

such products". All the Article XX exceptions must also meet the nondiscriminatory conditions set out in the chapeau of the article.

The understanding that none of the GATT exceptions is designed to promote a domestic industry was explicitly confirmed from the early days of the trading regime. A 1950 Report of the Working Party on "The Use of Quantitative Restrictions for Protective and Other Commercial Purposes" concluded that the GATT "does not permit the imposition of restrictions upon the export of a raw materials in order to protect or promote a domestic industry, whether by affording a price advantage to that industry for the purchase of its materials, or by reducing the supply of such materials available to foreign competitors, or by other means."[92]

There have been only a handful of disputes involving export restrictions in the GATT/WTO history.[93] Typically, the defendant country was accused of using export restrictions to protect its downstream producers at the expense of their foreign competitors. For instance, in *Canada-Salmon*, the United States claimed that Canada's regulations prohibiting the export of unprocessed salmon and herring were a clear violation of Article XI, designed to protect Canadian processors and promote Canadian jobs at the expense of foreign processors.[94] Canada defended its measure by invoking Article XI:2(b), which allows export restrictions necessary to maintain product standards, and Article XX(g), which excuses measures relating to the conservation of exhaustible natural resources, but failed on both counts.

The recent WTO ruling in *China–Raw Materials* also confirms that GATT Article XX may not be used to justify a policy that is primarily aimed at domestic economic development. In this case, China openly admitted that its export restraints are aimed at promoting domestic downstream industries, although its main argument was that the development of downstream industries would help to improve the environment in the long run.[95] China invoked Article XX(g) to defend its position. In addressing China's defense, the Panel referred to Article XX(i) as an immediate context for Article XX(g), which allows restrictions on exports of domestic materials necessary to ensure supply to a domestic processing industry, but requires that the restrictions "do not increase protection of such domestic industry and do not

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[92]GATT Analytical Index, Article XX(i), p. 547.

[93]See GATT Analytical Index, Article XI, and WTO Analytical Index, GATT Article XI.

[94]See Panel Report, *Canada–Measures Affecting the Export of Unprocessed Herring and Salmon*, GATT L/6268, adopted on 22 March 1988, GATT Basic Instruments and Selected Documents (BISD), 35S/98, paras. 3.11, 3.29, 3.33.

[95]China argued that the imposition of export restrictions would allow China to develop its economy in the future. "The reason for this is that export restraints encourage the domestic consumption of these basic materials in the domestic economy. Consumption of the basic materials at issue by downstream industries..., and the consequent additional production and export of higher value-added products, will help the entire Chinese economy grow faster and, in the longer run, move towards a more sophisticated production bundle, away from heavy reliance on natural resource, labor-intensive, highly polluting manufacturing. This move towards higher-tech, low-polluting, high value-added industries, in turn, will increase growth opportunities for the Chinese economy, generating positive spillovers beyond those to firms directly participating in these markets." Panel Reports, para. 7.514 (quoting China's comments).

depart from the principle of nondiscrimination." In the Panel's view, Article XX (g) should not be interpreted to allow a Member to do indirectly what Article XX (i) prohibits directly. In conclusion, "WTO Members cannot rely on Article XX (g) to excuse export restrictions adopted in aid of economic development if they operate to increase protection of the domestic industry."[96]

3.2.3 Tariffs Remain the Only Lawful Means of Restricting Exports for Developmental Purpose

The world trade regime has long recognized the need for "positive efforts" designed to ensure that developing countries benefit from trade for their economic development.[97] To this end, GATT Article XVIII *Government Assistance to Economic Development* allows a Member to deviate from certain GATT obligations in order to promote infant industries.[98] GATT Part IV *Trade and Development* recognizes specifically the need for developing countries to diversify the structure of their economies and to avoid an excessive dependence on the export of primary products.[99] However, the provisions concerning infant industries focus on import restrictions only.[100] The efforts offered under GATT Part IV to accommodate the need of developing countries to diversify their economies also focus exclusively on the improvement of market access and conditions for the primary and processed products from these countries.[101] While numerous other WTO agreements contain provisions granting special and differential treatment to developing countries, none of them is concerned with the use of export restrictions as a means for economic development.

Therefore, under the existing WTO agreements, tariffs remain the only lawful means for restricting exports for the purpose of promoting domestic industries. Except for the several acceding Members, WTO Members are still free to claim a larger share in the distribution of its resources through export restraints, so long as the restraints take the form of duties, not quantitative or other nontariff measures. Put differently, export duties have been preserved, by default under WTO law, as the only legitimate tool to exercise a Member's sovereign right to freely dispose of its natural resources.

It should also be noted that, although levying export duties on raw materials can have the same economic effect as providing subsidies to domestic downstream industries, export restraints do not fall within the meaning of a subsidy under the

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[96]Id., para. 7.386. China did not appeal the Panel's ruling on this issue.

[97]See the WTO Agreement, Preamble.

[98]GATT Article XVIII:4(a) and (b); Sections A, C and D.

[99]GATT Articles XXXVI:4 and 5.

[100]See GATT Article XVIII:14.

[101]GATT Article XXXVIII:2(a).

SCM Agreement.[102] Some may consider this situation as a loophole in the system.[103] At a more fundamental level, however, it would be problematic to subject export tariffs on resource materials to the WTO subsidy discipline, considering that export duties are the only legitimate means available under WTO law for Members to exercise their sovereign right to natural resources for the purpose of developing domestic industries.

3.2.4 Implications for the Several Acceding Members

By undertaking to eliminate or bind export duties at specific rates, the several acceding Members have accepted a derogation of their sovereign right to the free disposal of their natural resources. The degree of derogation varies depending on the terms of accession for a particular country. In the case of China, Montenegro and Latvia, their obligation to eliminate export duties on all or substantially all products means that they have essentially forgone the right to use export restraints for developmental purposes. For Mongolia and Saudi Arabia, the constraint is limited to a single category of products. As for Vietnam, Ukraine and Russia, their rights to use export duties for developmental purposes are curtailed to the same extent as their export-duty bindings. Except for Russia, none of the acceding countries has the right to revise their export concessions.[104]

It is, however, legally problematic not to provide the several acceding Members with the right to modify or withdraw their export duty commitments. As previously noted, due to the uncertainty surrounding the amendment of accession protocols, the stand-alone commitments on export duties are de facto permanent obligations of the acceding Members. Short of withdrawing from the WTO, these countries have no readily available means to adjust these commitments under WTO law. Insofar as raw materials are concerned, the lack of a clear right on the part of a WTO Member to modify or withdraw its export concessions is at odds with the principle of permanent sovereignty over natural resources.[105]

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[102]See Panel Report, *United States–Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted 23 August 2001, para. 8.75.

[103]See the EU proposal on export taxes, supra note 17 (stating that "when used for industrial or trade policy purposes, export taxes can serve as indirect subsidization of processing industries and influence international trading conditions of these goods").

[104]See Appendix.

[105]Supra text at notes 85–87.

3.3 Export Duties and Environmental Protection

A resource-producing country may wish to restrict the export of raw materials in order to conserve exhaustible natural resources and to reduce environmental damage associated with their production. Both purposes are recognized as legitimate by the WTO, which declares sustainable development and environmental protection as among the objectives of the world trade system.[106] To justify an export ban or other quantitative restrictions imposed for environmental purposes, the resource-producing country may invoke the pertinent provisions of GATT Article XX. Over time, Article XX jurisprudence has evolved significantly towards a more environmentally friendly position.[107] In principle, it has been established that a Member has the right to determine the level of environmental protection as it deems appropriate, provided that the right is exercised in a nondiscriminatory manner. Yet, as explained below, the nondiscrimination requirement can also get in the way of environmental interests. And it is in this context that export duties have a positive role.

3.3.1 Partial Conservation and Incremental Improvement

Under GATT Article XX(g), a WTO Member may adopt export restrictions for the purpose of conserving exhaustible natural resources if the restrictions "are made effective in conjunction with restrictions on domestic production or consumption." Article XX(g) has been interpreted to require that the measures in question be "primarily aimed" at the conservation, and that there is "even-handedness" in the restrictions imposed on domestic and foreign producers respectively.[108] A measure falling within Article XX(g) must in addition satisfy the requirement of the chapeau of Article XX that it is "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."[109]

[106]See the WTO Agreement, Preamble.

[107]The change is well summarized by a group of WTO experts: "[I]n the GATT days, assessment of the appropriateness of public policy exceptions were made primarily in terms of trade considerations, with a view to ensuring that such exceptions caused as little disruption of trade as possible." In contrast, nowadays "trade considerations are only one part of the reckoning, with much more emphasis on the public policy aim." Patrick Low, Gabrielle Marceau and Julia Reinaud, *The Interface between the Trade and Climate Change Regimes*: *Scoping the Issue* (2010), p. 33, available at http://www.wto.org/english/res_e/reser_e/climate_jun10_e/background_paper3_e.pdf.

[108]Appellate Body Report, *United States–Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996 (*US–Gasoline*), pp. 18–19, 20–21.

[109]In theory, the chapeau language can be interpreted to allow differential treatment between countries where different conditions prevail. In practice, the Appellate Body has not focused on the element of "conditions" in its interpretation of the chapeau. For a critique of this interpretive approach, see Julia Ya Qin, *Managing Conflicts Between WTO and RTA Rulings*: *Reflections on the Brazil-Tyres Case*, in Pieter Bekker, Rudolf Dolzer and Michael Waibel (eds.), Making

Alternatively, a Member can impose export duties to achieve the same goal, free from the constraints of Article XX. This “freedom” is valuable to a resource-producing country because it affords the country with a great deal of flexibility in designing its environmental policies. For example, a country may wish to reduce the consumption of a particular raw material to conserve an exhaustible natural resource, but is also concerned with job loss in domestic industries depending on the raw material as input. The country then may decide to impose an export duty on the raw material without similarly taxing domestic consumption. In this case, the measure may not be highly effective for conservation purposes since the export duties would lower the domestic price of the material, which in turn might stimulate domestic consumption. However, the country can still achieve a degree of conservation as long as the increase in domestic consumption caused by the export levy does not completely offset the reduction in foreign consumption. Such a policy, if implemented through export quotas, would conflict with the nondiscrimination requirements of Article XX.

In essence, the ability to levy export duties allows a resource-producing country to pursue a partial conservation policy that discriminates against foreign users. One may view export duties as a policy tool that provides the resource-producing country with the flexibility to protect and preserve the environment “in a manner consistent with their respective needs and concerns at different levels of economic development.”[110] Ultimately, the resulting discrimination against foreign users can only be justified by the permanent sovereignty of the country over its natural resources.

3.3.2 Managing Negative Externalities

Production of raw materials is often highly polluting to the local environment. When a resource-producing country does not have adequate environmental standards in place, the resource products can be sold cheaply without reflecting the true cost of production. The mispriced goods provide a commercial benefit to all purchasers, domestic and foreign; but the negative environmental externalities may have to be absorbed by the resource-producing country alone. When this happens, the resource-producing country is effectively subsidizing foreign consumers at the expense of environmental degradation at home. An export duty, set at a proper level, can correct the mispricing and offset the potential subsidy to the importing countries.

It is important to note that the negative environmental externalities cannot be easily addressed by the Article XX exceptions due to their nondiscrimination requirements. As acknowledged by the WTO Report on Resource Trade, “the principle of nondiscrimination may constrain the ways in which a WTO Member

Transnational Law Work in the Global Economy: Essays in Honor of Detlev Vagts (Cambridge U. Press, 2010), 601–29.

[110]The WTO Agreement, Preamble.

can impose measures designed to manage externalities."[111] Take the case of *China–Raw Materials* for example. In this case, China invoked Article XX(b) to justify its export restrictions on a number of "energy-intensive, highly polluting, resource-based products" (the "EPR" products), including coke, magnesium, manganese, and silicon carbide. China argued that its export restrictions are necessary because environmental regulations alone cannot fully address the environmental damage caused by EPR production. Without export restrictions, China argued, EPR export prices would be too low with respect to the social cost of production of EPRs, as they would not take into account the environmental costs of such production.[112]

The Panel disagreed. In its view, export restrictions generally do not internalize the social environmental costs of EPRs' production in the domestic economy, because export restrictions reduce the domestic prices of EPRs and therefore stimulate, instead of reducing, further consumption of polluting EPR products. According to the Panel, export restrictions are not an efficient policy to address environmental externalities when such externalities derive from domestic production rather than exports or imports. "This is because generally the pollution generated by the production of the goods consumed domestically is not less than that of the goods consumed abroad. So the issue is the production itself and not the fact that it is traded."[113] Thus, the Panel interpreted the necessity standard of Article XX(b) as requiring equal treatment between domestic and foreign interests in this situation.[114]

The Panel's reasoning, however, ignores an important dimension of the situation: it may be fundamentally unfair to require China to absorb the negative externality generated by the production of the raw materials to be consumed abroad. When the prices do not fully reflect the environmental costs of production, China is effectively "subsidizing" *all* consumers with the mispriced materials. When EPR products are sold domestically, their full environmental costs will be borne by the Chinese society, which must live with the consequences of environmental degradation caused by EPR production. Such costs may or may not be shared equitably within the society, but they will have to be absorbed eventually by China as a nation. In contrast, when EPR products are sold to foreign consumers, the uncompensated portion of the environmental costs will also be borne by China, as the environmental damage caused by EPR production is typically confined to the region of production. In this situation, foreign consumers benefit from the low-priced materials without ever having to pay for their full environmental costs. The net effect is a "subsidy" or a transfer of wealth from China to the importing countries of EPR products.

The issue here is not whether the resource-producing country can require foreign consumers to pay for their fair share of the environmental costs – as it certainly can – but how. In theory, the most effective way to manage the negative externalities

[111] WTO Report on Resource Trade, supra note 3, at 169.

[112] Panel Reports, para. 7.585.

[113] Id., para. 7.586.

[114] The Panel's finding under Article XX(b) was not appealed.

should be to address the problem at the source, that is, to raise the prices of EPR products through stricter enforcement of environmental standards and/or high taxes on EPR production. However, in practice, it can be much more difficult to implement production control than export control, especially in large developing countries that lack the proper institutional capacity to enforce production rules uniformly.[115] In such situations, export duties may be the single most effective and efficient way to compensate for negative externalities generated by the EPR products consumed abroad.[116] This policy tool, however, is no longer available to China and other acceding Members that have given up the right to impose export duties. To comply with its WTO obligations, China must either find a way to raise the prices of EPR products across the board, or continue to subsidize foreign users with mispriced EPR products. In any event, it will not be allowed to sacrifice the environment for the benefit of its domestic industries only; instead, the bounty of cheap EPR products must be shared equally among domestic and foreign consumers, irrespective of how the environmental costs are allocated.

In addition to subsidizing foreign consumers, mispricing of EPR products on a long-term basis may induce the migration of dirty industries to the developing countries that do not enforce proper environmental regulations.[117] The shift in production of rare earths provides such an example. The Mountain Pass Mine in the United States used to be the world's largest producer of rare earths, but closed its mining operations in 2002, amid environmental concerns and cut-rate competition from China.[118] For decades, China mined and processed rare earths with little environmental protection, leaving vast toxic waste sites, and cancer and birth defects among residents and animals.[119] The lax environmental policy combined

[115] See Karapinar, supra note 17, at 1152.

[116] By contrast, export quota is not an effective means for correcting the mispricing of EPR products sold abroad, due to its indirect and uncertain relationship with the price of exports. This would be the case whether or not the export quota is implemented in conjunction with restrictions on domestic production (i.e., in a nondiscriminatory manner consistent with GATT Article XX).

[117] See John Wilson, Tsunehiro Otsuki and Mirvat Sewadeh, *Dirty Exports and Environmental Regulation: Do Standards Matter to Trade?* World Bank Policy Research Working Paper No. 2806 (March 2002) (finding that more stringent environmental standards imply less net exports of pollution intensive industries, and that environmental legislation has a more dramatic effect on net exports in OECD countries than in non-OECD countries), available at http://ssrn.com/abstract=636089.

[118] See Martin Zimmerman, *California mine regains lust*, Los Angeles Times, Oct. 14, 2009; Andrew Restuccia, *Troubled mine holds hope for US rare earths industry*, The Washington Independent, Oct. 25, 2010, at http://washingtonindependent.com/101462/california-mine-represents-hope-and-peril-for-u-s-rare-earth-industry.

[119] See Allison Jackson (AFP), *China pays price for world's rare earths addiction*, April 30, 2011, at www.google.com/hostednews/afp/article/ALeqM5gcxkj7mOtDf2Kv3DHxC2KFkRKy7g; Asia Sentinel, *China's Rare Earths Mining Catastrophe*, June 21, 2011, available at www.asiasentinel.com; Keith Bradsher, *The Fear of Toxic Rerun*, New York Times, June 29, 2011.

with low-cost labor made China's rare earths extraordinarily cheap, driving out competition from other countries.[120] As a result, China now supplies more than 95 % of global demand, even though it has only 30 % of the world's known reserves.[121]

3.4 Impact of WTO Rulings in China–Raw Materials: The Case of Rare Earths

While the dispute in *China–Raw Materials* was pending, a new controversy broke out over China's export restrictions on rare earths. The issues involved are essentially the same as those in *China–Raw Materials*, but the stakes are higher because rare earths are critical inputs to many high-tech products, including smart phones, computers, hybrid vehicles, and energy saving lightings. *China–Raw Materials* thus has become a test case for the rare earths dispute.[122] The WTO rulings, however, have met with certain responses from China that highlight the problems discussed in the previous sections.

3.4.1 Background of the Rare Earths Controversy

As noted above, China's exports of rare earths has increased tenfold since 1990.[123] The rapid expansion in production is quickly depleting China's rare earths deposits. According to the Ministry of Commerce, China's medium and heavy rare earths may last 15–20 years at the current rate of production, possibly requiring imports in the future.[124] To conserve resources, China began to apply export quotas on rare earths in 1998, but the quotas allocated each year were more than sufficient to cover

[120]From 1990 to 2005, China's rare earths exports increased nearly tenfolds, and their export prices dropped by 50 %. Zhongxinwang, *Rare earths sold at the price of dirt? China should insist on export control over rare earths*, July 7, 2011 (in Chinese), at http://edu.chinanews.com/cj/2011/07-07/3163654.shtml.

[121]Of the world's known reserves, China has the largest share (30 %), followed by the United States (13 %), Australia (5 %), and India (2.5 %). Jane Korinek and Jeonghoi Kim, *Export Restrictions on Strategic Raw Materials and Their Impact on Trade and Global Supply*, 45 (2) J. World Trade 255 (2011), at 271. For a comprehensive report on China's rare-earth industry and policy, see Pui-Kwan Tse, *China's Rare-Earth Industry*, U.S. Geological Survey Open-File Report 2011–1042 (2011), at http://files.eesi.org/usgs_china_030011.pdf.

[122]See generally Gu, supra note 5.

[123]Supra note 120.

[124]Bloomberg News, *China Rare Earths to Last 15–20 Years, May Import*, Oct. 16, 2010, at http://www.businessweek.com/news/2010-10-16/china-rare-earths-to-last-15-20-years-may-import.html.

foreign demand.[125] In July 2010, however, China suddenly slashed the export quotas by 40 %.[126] Two months later, it briefly halted shipping of rare earths to Japan over a territorial dispute.[127] These events prompted an outcry from the United States, Japan and the EU, the world's largest importers of the minerals. In addition to quotas, China also introduced a 10 % export tax on rare earths in 2006, which has since increased to 15–25 %.[128] Despite their strategic importance, rare earths are not among the 84 products on which China may levy export duties in accordance with its accession protocol.[129]

China maintains that its export restraints on rare earths are taken for conservation and environmental purposes consistent with WTO rules, even though domestic consumption has not been similarly restricted. The rulings in *China–Raw Materials* have exposed the vulnerability of China's position. On March 13, 2012, the United States, Japan and the EU launched formal WTO disputes with China, challenging its export restrictions on rare earths.[130] It remains to be seen whether China can successfully defend itself in this case.

3.4.2 Government and Public Responses

Following the release of the Panel decision in *China–Raw Materials* to the parties in April 2011, China began to shift its rare-earths strategy visibly. In a new policy document issued in May 2011, the central government laid out the basic principles for the development of the rare earths industry.[131] While reaffirming the policy of export restrictions, the document emphasizes the government's resolve to control rare earths production. The production control will be carried out by various means, including cracking down illegal mining, enforcing environmental regulation and raising resource taxes, but above all, it will be carried out by mandatory State planning and by consolidation of the industry.[132] The government will compel

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[125] Korinek and Kim, supra note 121, Table 13. China's practice did not give rise to protest from importing countries in the early years, even though the quota clearly violated GATT Article XI and it was questionable whether they met the conditions of the environmental exceptions under Article XX.

[126] Reuters, *China cuts 2010 rare earth export quotas 40 pct-paper*, Aug. 11, 2010, at http://af.reuters.com/article/metalsNews/idAFTOE67A03H20100811.

[127] Keith Bradsher, *Amid Tension*, *China Blocks Vital Exports to Japan*, New York Times, Sept. 22, 2010.

[128] People's Daily, *Export tax to be raised on rare earths*, Dec. 15, 2010, available at http://english.peopledaily.com.cn.

[129] Supra note 25.

[130] Supra note 4.

[131] State Council, *Several Opinions on the Promotion of Sustaining and Healthy Development of the Rare Earths Industry*, Guofa [2011], No. 12, May 10, 2011.

[132] Presently there are more than 300 rare-earth producers; and the goal is to reduce that number to around twenty. See Tse, supra note 121.

mergers and acquisitions of small and medium-sized producers, typically private companies, and let a few large state-owned enterprises (SOEs) dominate the field.[133]

Thus, in anticipation of a new WTO challenge, China has decided to place the rare-earth industry under a firmer control of the State. The large SOEs will be able to set prices and choose to sell their products to domestic producers rather than to export. Although China's accession protocol requires the Chinese government to ensure that all its SOEs will "make purchases and sales based solely on commercial considerations" and that other WTO Members will "have an adequate opportunity to compete for sales to and purchases from these enterprises on nondiscriminatory terms and conditions",[134] it will be very difficult to monitor SOE activities given the lack of transparency in their operations.

Since the release of the Appellate Body's report, China has expressed its strong disagreement with the WTO ruling.[135] Meanwhile, the Chinese press has indicated that the government will obey the ruling, but will find other "nontariff and non-quota" ways to avoid WTO constraints.[136]

The rare earths controversy, and the WTO ruling in *China–Raw Materials*, has been widely reported in China. The case has aroused strong nationalistic feelings, and public opinion overwhelmingly supports the export restrictions.[137] In the view of many, China must "fight the battle" to protect its strategic resources from the grab of Western powers.[138] "Free trade" may not override the fundamental rights of a nation.[139] And "the rest of the world has to realize that China cannot go on

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[133]China permits Sino-foreign joint ventures to engage in the production and export of rare earths. It appears there are a dozen or so such joint ventures. Tse, supra note 121.

[134]Report of the Working Party on the Accession of China, WT/MIN(01)/3 (10 November 2001), para. 46, which paragraph was incorporated into China's Accession Protocol.

[135]See BNA WTO Reporter, *U.S., EU and Mexico Urge China to Lift Export Restrictions in Wake of WTO Ruling*, 23 February 2012 (reporting that China told the Dispute Settlement Body that the Appellate Body and Panel rulings are improper and will risk creating an unsustainable two-tiered system where new Members do not have the same right to promote fundamental societal interests as established Members).

[136]See Zhongcaiwang, *WTO Claims "Victory", China's Battle to Defend Rare Earths Is Ready to Be Set Off*, Feb. 4, 2012 (in Chinese), at http://www.cfi.net.cn/p20120204000308.html.

[137]In an online poll conducted soon after the case of *China–Raw Materials* was filed at the WTO, nearly 90 % of the people responded support China's restriction on the export of strategic resources. Huanqiuwang, *Nearly 90 % of Netizens Vote in Favor of China's Restrictions on the Export of Strategic Materials*, June 14, 2009 (in Chinese), at http://world.huanqiu.com/roll/2009-06/487700.html.

[138]See e.g., WANG Junzhi, *China's Battle to Defend Rare Earths*, China Economics Press, January 2011 (in Chinese); Hexun, *China sets off the battle to defend rare earths* (in Chinese), at http://news.hexun.com/2010/xitu/index.html.

[139]Xinhua.net, *China's export restriction on rare earths is consistent with WTO rules*, May 21, 2011, http://news.xinhuanet.com/politics/2011-05/21/c_121441790.htm.

sacrificing its environment for the benefit of other countries."[140] The WTO ruling is therefore perceived as unfair, exposing the WTO as an organization lacking understanding of the problems of developing countries.[141]

In this context, it was also reported in the Chinese media that, while suing China for export restrictions on raw materials, the EU and the United States have been simultaneously levying antidumping duties on some of the very materials involved in their WTO complaints.[142] The incoherence in the EU and US trade policies provides further evidence for the belief that the WTO complaints against China's export restrictions are unjustified.[143]

In sum, while the WTO decision may prompt China to tighten environmental regulations across the board, it has also met with two responses that are undesirable from a systemic perspective of the WTO. First, the move to increase the State control in the resource sector goes in the opposite direction from the market-oriented economic reform that WTO accession is supposed to promote. The result may give rise to more serious conflicts between China and other Members, as the issues of SOEs are among the hardest to address under WTO law. Second, the WTO ruling has triggered nationalistic reactions from the Chinese. The negative image ensuing from the WTO ruling may well undermine public support for initiatives to liberalize trade in the future.

China's predicament, of course, stems from its sweeping accession commitments on export duties–most other WTO Members will not be similarly constrained.[144] But its ultimate disadvantage lies in the lack of any realistic chance to adjust such commitments. If its export duty commitments could be modified in a manner similar to its import duty commitments, China would have some policy space to adjust the level of its resource exports. In that event, the government might not be compelled to resort to non-market means to avoid WTO constraints, and the public might not be so concerned since the stake would not be as high.

[140] Mei Xinyu, *WTO Ruling Not End of Road for China*, China Daily, July 20, 2011, available at www.chinadaily.com.cn.

[141] Id. There is also a call for China to fight for the revision of "the unequal clause" in its accession protocol. Id.

[142] See Xinhua, *A regrettable WTO ruling*, July 6, 2011, at http://news.xinhuanet.com. Since 2008, the EU has imposed an antidumping duty of 25.8 % on certain coke imported from China. Council Regulation (EC) No. 239/2008 of 17 March 2008. The United States currently maintains antidumping duties on magnesium, coke and silicon metal from China. Source: USITA, http://web.ita.doc.gov. See also Daniel Ikenson, *Economic Self-Flagellation*: *How US Antidumping Policy Subverts the National Export Initiative*, Cato Institute Trade Policy Analysis no. 46, May 31, 2011.

[143] See e.g., Ye Tan, *China's export restriction on rare earths is justified and reasonable*, July 8, 2011 (in Chinese), at http://www.ibtimes.com.cn/articles/20110708/xitu-chukou.htm.

[144] This fact, however, has rarely been mentioned in the public discourse in China. Apart from the difficulty in explaining the technical details of WTO rules, the government may not be keen on publicizing the WTO-plus obligations it has undertaken.

4 The Road to Reform

The China case highlights one side of the problem in the existing WTO export duty regime: the stand-alone obligations imposed on the selected acceding Members are so rigid that they may backfire. The other side of the problem, of course, is the complete lack of obligation to limit the use of export duties on the part of most WTO Members. The system is badly in need of reform.

4.1 Establishing a System-Wide Discipline on Export Duties

4.1.1 Reaffirm the Need for Regulating the Use of Export Duties

The world trade system has long recognized that export duties "often constitute serious obstacles to trade" and that negotiations should be directed to "the substantial reduction of the general level of tariffs and other charges on imports and exports".[145] Today, the need for a system-wide discipline on export duties is greater than ever. With the emergence of global supply chains and rapid industrialization in the developing world, many economies have become dependent on the import of raw materials and intermediate goods.[146] Yet, in the meantime, the use of export tariffs has proliferated, especially on resource products. According to WTO statistics, 11 % of world trade in natural resources, and 5 % of total world trade, is now covered by export taxes.[147] More than 30 countries are among the main users of export taxes in natural resources, all of which developing nations.[148] The trend is expected to continue, as the global demand for resource products continues to outpace their supply and the development of alternative resources takes time.

Unconstrained use of export duties creates uncertainty and unpredictability in global trade. More seriously, export restraints increase tension in international relations and can provoke retaliation. In some countries, the mounting pressure for access to raw materials has already turned resource trade into a matter of "high

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[145] GATT Article XXVIII *bis*, para. 1. The provision was added to the General Agreement during the review session of 1954–1955. See GATT Analytical Index, Article XXVIII *bis*.

[146] For example, about 70 % of all imports to the EU in 2007 were intermediate goods headed for transformation there. Peter Mandelson, *The Challenge of Raw Materials*, Speech at the Trade and Raw Materials Conference, Brussels, 29 September 2008, at http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/467&type=HTML.

[147] WTO Report on Resource Trade, supra note 3, at 116–117.

[148] Id., Figure 30, at 119. The figure does not include Russia, which was not a WTO Member at the time, but a major exporter of natural resources and a heavy user of export taxes. See Mandelson, supra note 146 (noting that when Russia imposed an export duty of 50 % on scrap aluminum, which "has all but wiped out trade in this metal").

politics" of national security.[149] The increasing use of export restrictions on agricultural products has also raised the grave concern for food security in recent years.[150] The lack of an effective WTO discipline on export restraints, therefore, may develop into a risk for political instability in the world.

In short, it is time for the WTO to reaffirm the need for regulating the levy of export duties. Having an effective WTO discipline on export restraints should benefit developed and developing countries alike. Many developing nations are not resource-rich, and very few are endowed with all the natural resources necessary for economic advancement. A system-wide discipline can provide a high degree of security and transparency in the access to world's resources for all.

4.1.2 Regulate Export Duties in the Same Way as Import Tariffs, Taking into Account Their Legitimate Functions

To garner the support of major developing country members, the new WTO discipline needs to acknowledge the legitimate functions of export duties. However, the major proposals tabled within the WTO to date have generally opposed the use of export duties for industrial policy or trade purposes.[151] This stance has been carried to an extreme by the WTO ruling in *China-Raw Materials*, which effectively prohibits several acceding Members from using export duties for any purpose.

Thus, at least in the context of accession, the WTO has chosen to regulate export duties more strictly than import duties. With respect to import duties, WTO law continues to recognize them as a legitimate means of protecting domestic industries. Even after eight rounds of tariff negotiations, most WTO Members still maintain extensive uses of import duties, albeit the average rates of duty have lowered significantly. All import tariff bindings are entitled to public policy exceptions and may be modified or withdrawn on a regular basis. Moreover, developing countries are given extra flexibility in the use of import duties and are not required to make concessions inconsistent with their "development, financial and trade

[149]Mikkal Herberg, Introduction to NBR Special Report No. 31, Asia's Rising Energy and Resource Nationalism: Implications for the United States, China and Asia-Pacific Region (September 2011), at 3.

[150]A survey by the Food and Agricultural Organization of the United Nations found that 25 developing countries imposed ban or increased taxes on the export of agricultural products in recent years. *Price Volatility in Food and Agricultural Markets*: *Policy Responses*, Policy Report jointly issued by FAO, IFAD, IMF,OECD, UNCTAD, WFP, the World Bank, the WTO, IFPRI and the UN HLTF (June 2, 2011), para. 37, at http://www.ifad.org/operations/food/documents/g20.pdf. See also Thomas J. Schoenbaum, *Fashioning a New Regime for Agricultural Trade*: *New Issues and Global Food Crisis*, 14(3) J. Int'l Econ. Law 593 (2011).

[151]See Communication from the European Communities, *Market Access for Non-Agricultural Products*: *Negotiating Proposal on Export Taxes*, TN/MA/W/11/Add.6 (27 April 2006) (proposing the elimination of export duties by all Members); and the revised EU proposal on export taxes, supra note 17 (proposing a less strict approach than the 2006 proposal).

needs".[152] In contrast, the WTO has required selected acceding countries, all of which developing economies, to abolish export duties altogether or to eliminate export duties on numerous products. Their export duty concessions are fixed as stand-alone obligations, without the benefit of policy exceptions (unless specifically provided otherwise in the accession protocol) or a realistic chance for adjustment.

Is this harsher treatment of export duties warranted, however? From an economic standpoint, export duties do not produce greater trade-distorting effects or welfare loss than import tariffs.[153] It is true that due to uneven geographical distribution of natural resources, a small number of countries may control the world's supply of a particular material; consequently, when a major supplier country levies a heavy duty or suddenly changes its levy on the export of a resource material, it may cause special difficulties for all the importing countries relying on its supply. This problem, however, concerns the level and the predictability of export duties, rather than the use of export duties per se; and it can be adequately addressed by the binding of duties and by the strengthening of transparency requirements on export levies.[154] In this context, it is also relevant to note that as the owner of its natural wealth, the resource-producing country may rightfully seek "rents" from the sale of its resources to other countries.[155] In contrast to rents in manufactures or services, which can be bid away by expanding production elsewhere, the rents on depleting natural assets are intrinsic to the scarcity of global natural resources.[156] Such rents therefore properly belong to the country in which the resource endowment is located.

As discussed in detail above, export duties have a number of distinct functions that should be recognized as legitimate.[157] In light of these functions, especially their utilities for developing countries, WTO disciplines should not treat export duties more harshly than import duties. Instead of requiring their elimination, the WTO should acknowledge the legitimate uses of export duties, aiming to strike a balance between the interests of importing and exporting countries through tariff bindings. The negotiation and regulation of export tariff bindings may follow the

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[152] *Differential and More Favorable Treatment*, *Reciprocity and Fuller Participation of Developing Countries* (*The Enabling Clause*), GATT Doc. L/4903 (Nov. 28 1979), BISD 26S/203 (1980), para. 5.

[153] The sum of welfare loss generated by export duties should be the same as that generated by import tariffs, albeit the distributional effects of the two may differ. Notably, in the case of export duties consumer loss may spread across multiple countries, whereas in the case of import tariffs consumer loss concentrates in the single importing country. For a detailed study on the economic implications of export taxes, see Roberta Piermartini, *The Role of Export Taxes in the Field of Primary Commodities* (WTO Publications, 2004), at https://www.wto.org/english/res_e/booksp_e/discussion_papers4_e.pdf.

[154] See the EU proposal on export taxes, supra note 17.

[155] Resource deposits typically carry rents, as the value of output well exceeds the cost of production. Paul Collier and Anthony J. Venables, *International Rules for Trade in Natural Resources*, WTO Staff Working Paper ERSD-2010-06, January 2010, available at www.wto.org.

[156] Id.

[157] See Part III.

same GATT norms governing import tariff bindings, taking into account the special features of resource trade. In short, export duties can and should be regulated in the same way as import duties under WTO law.

4.2 Bringing All Stand-Alone Export Concessions into GATT

As previously analyzed, the stand-alone export duty obligations of the acceding Members are problematic for both legal and policy reasons. Legally, the lack of right to modify or withdraw export duty commitments is at odds with the principle of permanent sovereignty over natural resources under international law. The unavailability of public policy exceptions to the export duty commitments cannot be explained by any WTO principles. Within the system, the stand-alone obligations create multiple tiers of members, causing fragmentation of WTO law. As can be observed in the case of China, the rigid stand-alone obligations may backfire – causing the country to resort to less transparent means to achieve the same goal.

The stand-alone obligations are contractually agreed between the WTO and the individual acceding countries. The fact that the obligations have been accepted by the acceding Member, however, does not justify maintaining such a seriously flawed arrangement.[158] Instead, the WTO should acknowledge that the arrangement is flawed and be prepared to rectify the situation.

4.2.1 Create "Part V" of GATT Schedules for the Acceding Members

A principled solution to the problem of stand-alone export duty commitments is to bring all of them into the GATT framework. Currently, each WTO Member has a "Schedule of Concessions and Commitments" annexed to the GATT.[159] Each GATT Schedule consists of four parts: Part I lists MFN concessions, Part II preferential concessions, Part III concessions on nontariff measures, and Part IV the specific commitments made during the Uruguay Round on domestic support and export subsidies on agricultural products.[160] In the case of Russia, as noted above, a new Part V has been created to list its extensive concessions on export duties.[161]

Following the Russian example, a "Part V" could be added to the GATT schedules of the acceding Members to record their export duty commitments set

[158]See supra text at note 46 regarding the political reality of accession negotiations.

[159]The schedule is binding on the Member by virtue of GATT Article II:7, which states: "The Schedules annexed to this Agreement are hereby made an integral part of Part I of this Agreement."

[160]Hoda, supra note 53, at 19.

[161]Part II.B.4.

out in the accession protocols. It would be straightforward to record all the bindings at specific rates, as in the case of Vietnam, Ukraine, Latvia (specific antiques) and China (84 products).[162] For the commitments to eliminate export duties, a conversion to 0 % would be required. This would not be hard in the case of Mongolia, Saudi Arabia and Latvia, as their commitments to eliminate duties concern a small number of products only. As for China and Montenegro, whose commitments to eliminate export duties are across the board, the recording might be done by reference to the relevant provisions of the accession protocol. Thus, Part V of the GATT Schedule for China could simply provide: "See the commitments in Paragraph 11.3 and Annex 6 of the Accession Protocol".[163]

Procedurally, there is a question concerning the proper mechanism for adopting "Part V" into the GATT schedules of the acceding Members. Since the accession protocols do not provide for the incorporation of export duty commitments into the GATT schedules, one might argue that such a move would require amendment to the accession protocols. If this view prevails, there would be serious doubts about the feasibility of the incorporation, given the legal uncertainty surrounding the revision of accession protocols.[164]

It is important to note, however, that adding Part V to a GATT schedule is a matter of amending the GATT schedule, which is legally distinct from amending the accession protocol. Technically, any amendment to a GATT schedule shall require unanimous consent of all WTO Members, since the schedule constitutes an integral part of GATT Article II.[165] Yet, an early GATT decision has clarified that the rates of duty contained in the schedules were meant to be maximum rates only; therefore, a reduction in the rate of duty on a product below the rate set forth in a schedule would not require unanimous consent.[166] In practice, Members have relied on internal GATT procedures to record unilateral, bilateral and plurilateral concessions.[167] Thus, should India declare that it would make a unilateral commitment to bind its export duties on ten mineral products at 20 %, the WTO would be able to accommodate this trade-liberalizing move by recording the commitment in India's GATT Schedule (possibly by adding Part V to it). Since India's export duties are currently "unbound", the new concessions would be considered a modification of its current GATT schedule. By the same token, insofar as their existing GATT schedules are concerned, the export duty commitments of the acceding Members

[162]See Appendix.

[163]This technique has already been used in Part IV of China's GATT Schedule, which incorporates China's commitments on agricultural subsidies by reference to "related commitments in the Working Party Report." See GATT Schedule CLII, People's Republic of China.

[164]See Part II.C.2(b).

[165]See GATT Article XXX; Article X:2 of the WTO Agreement.

[166]GATT Analytical Index, Article II, p. 101 (quoting the GATT decision on 9 August 1949, BISD Vol. II/11).

[167]Hoda, supra note 53, at 117 (citing the 1980 GATT decision on *Procedures for Modification and Rectification of Schedules of Tariff Concessions* (L/4962)).

would all be new concessions, therefore could be accommodated in the same fashion.[168]

The substantive issue here, of course, is whether the incorporation of the export duty commitments into the GATT schedules will prejudice the interests of other WTO Members. The incorporation would not change the scope of the existing export duty commitments. What would be changed is the rigidity of the commitments. As already explained, the lack of rights on the part of the acceding countries to invoke GATT policy exceptions and to adjust their commitments is problematic as a matter of fundamental WTO principles and may be challenged as inconsistent with the principle of permanent sovereignty over natural resources. The very purpose of incorporating the export duty commitments into the GATT is to cure this defect.

Considering that the incorporation would have practical implications for the terms of accession, it is recommended that a decision to approve the incorporation be taken by the WTO General Council following the same procedures for approving the terms of accession. In WTO practice, the decision to approve accession terms is taken under the Decision-Making Procedures Under Articles IX and XII of the WTO Agreement.[169] Pursuant to these Procedures, when dealing with matters "related to accessions", the General Council will seek a decision by consensus in accordance with Article IX:1 of the WTO Agreement; where a decision cannot be arrived at by consensus, the matter will be decided by a two-thirds majority vote of all Members in accordance with Article XII:2 of the WTO Agreement. This process would afford WTO Members an opportunity to focus on the issues raised by export tariffs and to clarify their common intentions behind those accession commitments. Once the General Council adopts the decision, the export duty commitments of the acceding Member can be recorded in its GATT schedule as new concessions that modify its existing schedule.

In connection with the approval process, it would be desirable for the General Council to confirm that GATT Article XXVIII can be applied to Part V of the GATT schedules.[170]

4.2.2 China Should Take the Lead in Reform

To initiate the process, the several acceding Members need to make the request for incorporating their export concessions into the GATT schedules. China, being the

[168]The recording of these new concessions should be made only after approval by a WTO decision as explained below.

[169]Adopted by the General Council on 15 November 1995, WT/L/93, 24 November 1995.

[170]See supra text at notes 60–66. Under Article IX:2 of the WTO Agreement, the General Council has the "exclusive authority to adopt interpretations" of the WTO agreements. This power has never been exercised in practice. To confirm the applicability of Article XXVIII to Part V of the GATT schedule would not require the General Council to exercise this authority if it does not amount to an interpretation of Article XXVIII.

first to face the legal consequences of such stand-alone commitments, should have the incentive to take the lead. The incorporation would give China the right to invoke GATT policy exceptions to justify departures from its export duty commitments. More importantly for the long run, it would give China the right to renegotiate its scheduled concessions.[171] The chance to renegotiate such concessions in the future would provide China with the policy space desired to address some of the systemic issues arising from *China–Raw Materials* and the rare-earths dispute.[172]

Bringing the stand-alone commitments into the GATT framework would be an important step toward the goal of establishing a system-wide discipline on export duties. The rigid obligations imposed on the selected acceding Members reflect a strong bias against the use of export duties as a tool for economic development. Their existence, therefore, cannot but discourage other developing country members from joining the effort to curb export restraints. For foreign policy reasons, China has supported other developing countries in their resistance to the call for a system-wide discipline, despite the fact that its economy is heavily dependent on the import of resource materials.[173] This policy, however, is shortsighted. As discussed above, the broad and long-term interest of the developing countries lies in a system-wide discipline that strikes a proper balance between the need of the importing countries to secure access to resources and the need of the exporting countries to preserve the legitimate functions of export duties. If China desires to play a greater role in WTO rulemaking, it should consider taking the lead in the reform of the current irrational system on export restraints.

[171]On the applicability of Article XXVIII, see supra text at notes 60–66. Pursuant to Article XXVIII, China would be expected to make compensatory adjustments in the renegotiation so as to maintain a general level of concessions no less favorable to trade than the status quo ante. The compensatory adjustment for the modification of a particular export duty commitment might take various forms, such as reductions in import duties on specific products, or commitments to cut domestic subsidies in specific sectors. If no agreement can be reached, the Members "primarily concerned" and with "a substantial interest" would be free to withdraw substantially equivalent concessions. The result of the Article XXVIII process would be applied to all other WTO Members on an MFN basis. See supra text at notes 51–53.

[172]Both the EU and the United State have resorted to the modification of schedules to resolve the underlying issues in WTO disputes after they lost in the disputes. In *EC-Chicken Cuts* (DS269, DS286), the EU, after initially complying with the WTO rulings, launched negotiations with Brazil and Thailand under GATT Article XXVIII, seeking to change the tariff rates mandated by the WTO rulings. See Goliath Business News, *EU/Brazil/Thailand*: *EU Preparing to Introduce Quotas on Chicken Cuts*, 29 Sept. 2006, at http://goliath.ecnext.com/coms2/gi_0199-7433324/EU-BRAZIL-THAILAND-EU-PREPARING.html. In *US-Gambling* (DS285), the United States never complied with the WTO ruling; instead, it modified its scheduled commitment at issue through negotiations with several Members pursuant to GATS Article XXI. See USTR, Statement on Internet Gambling, 21 December 2007, available at www.ustr.org.

[173]China is one of the largest importers of resources in the world. See supra note 15. To secure access to resources, China has been pursuing the strategy of foreign direct investment in resource-producing countries. For statistics, see Aaditya Mattoo and Arvind Subramanian, *A China Round of Multilateral Trade Negotiations*, Peterson Institute for International Economics Working Paper Series, WP 11–22, December 2011, Table 5 and Figure 5.

5 Conclusions

The current WTO regime on export restraints is irrational and badly in need of reform. The absence of a general discipline on the use of export duties leaves global production chains vulnerable to the instability and unpredictability in the supply of resource materials. And the lack of security in access to critical resources creates tension and can provoke retaliation in international relations. Yet, proposals to limit strictly the use of export duties have met continued resistance from developing country members. Unable to effect a systematic change, the WTO has nonetheless required a few acceding countries to make sweeping export-duty commitments. Such commitments are fixed as stand-alone obligations outside the GATT framework, thus depriving the acceding Members of the policy space and flexibility afforded by the GATT provisions. These country-specific rules have also resulted in incoherence in WTO law, and have created multiple tiers of Members with unequal rights and obligations within the WTO system.

It is submitted here that the key to beginning reform of the current regime lies in the recognition of the legitimate functions of export duties. The lack of such recognition at the systemic level is the fundamental reason why ultra rigid obligations on export duties have been imposed on the several acceding members. It also explains why calls for a system-wide discipline on export duties have failed to garner wide support from developing country members. Only when the legitimate roles of export duties are duly acknowledged can the developing countries be expected to take an interest in negotiating a general export-duty discipline.

Most critically, it is necessary for the WTO to acknowledge the role of export duties in promoting the economic development of resource-producing countries. The levy of export duties allows a resource-producing country to claim a larger share in the distribution of its natural resources for domestic use. History has shown that reserving scare resources for use by domestic producers is an effective means for developing economies to climb up the value chain. Despite criticism that such a policy has a “beggar-thy-neighbor” effect, it is nonetheless justifiable by the principle of permanent sovereignty over natural resources. Unlike other sovereign prerogatives, the sovereign right over natural resources, which includes the right to dispose of such resources freely for developmental purposes, has been recognized as a basic human right under international law. Although the exercise of such right is without prejudice to the treaty obligations a nation undertakes on its own free will, the WTO should take care to respect this fundamental principle of international law in the design of its trade disciplines. Since the GATT already prohibits the use of nontariff measures to restrict exports for developmental purposes, the only legitimate means a WTO Member may employ to claim a larger share in the distribution of its natural resources is through export duties. Thus, when the WTO obligates a Member to eliminate export duties on resource products, as it has done with several acceding Members, it strips away the right of that Member to dispose freely of its natural resources for developmental purposes. When such

obligations are made virtually immutable, as is the case with the several acceding Members, it amounts to permanent alienation of a Member's ownership right to claim a larger share of its natural resources for domestic use. Such an arrangement is arguably inconsistent with the concept of permanent sovereignty over natural resources.

It is also important for the WTO to acknowledge the role of export duties in managing environmental externalities. When the prices of recourse products do not fully reflect their environmental costs, the resource-producing country is effectively "subsidizing" the importing countries with mispriced resources at the expense of its own environment. In such a situation, export duties set at a proper level can offset negative externalities generated by the production of the resource products sold abroad. As shown in the case of China, when a Member loses the right to impose export duties, it is required under the nondiscrimination requirements of WTO law to share the bounty of its mispriced resource products with all foreign users, even though their environmental costs are not similarly shared. While in theory the most efficient way to manage such environmental externalities is to fix the regulation of the production process, for those developing countries that lack the necessary institutional capacities (poor governance) to deal with the problem at the source, taxing exports at the border remains a most practical and effective means to address the problem.

In the light of legitimate functions of export duties and their special utility for developing countries, it should become clear that the rigid obligations imposed on the acceding Members to eliminate export duties on resource products are problematic as a matter of WTO law and policy. Rather than treating export duties as more objectionable trade barriers than import duties and pushing for their elimination, the world trade system should aim to create export tariff bindings at levels appropriate for individual Members, with the goal of striking a proper balance between the need of WTO Members to have a secure and predictable access to the world's resources, and the need of the resource-producing countries to control exports as a means of achieving sustainable economic development.

Fortunately, in the view of this author, there exists a relatively simple, yet effective, way for the WTO to rectify this problematic state of affairs. That is, to incorporate all stand-alone commitments of the acceding Members on export duties into their respective GATT schedules. The Russia accession has already created the first-ever GATT schedule on export concessions. China and other acceding Members should follow the Russian precedent and request that their export duty commitments be similarly incorporated into their GATT schedules. The integration of the accession commitments into the GATT framework would provide the acceding Members with the policy space and flexibility available under the existing GATT provisions, thereby correcting part of the institutional bias and ensuring a greater degree of coherence and consistency within the WTO system. This integration would not change the content and scope of the export duty commitments, and therefore would not disturb the balance of rights and obligations negotiated under the accession protocols. Due to the separate legal existence of GATT schedules,

such integration would not raise the issue of amendment to the accession protocols, which remains surrounded by legal uncertainty. The creation of several new GATT schedules on export duties would regularize the practice for recording export duty commitments, which could help set the stage for future negotiations on the binding of export tariffs on a system-wide basis.

In sum, the world needs a sensible discipline on export restraints that can ensure secure and predictable access to resource products for all, while respecting the right of sovereign nations to reserve a larger share of their natural resources for the benefit of domestic industries, and the need of developing countries to use export duties for other legitimate purposes, such as managing environmental externalities. The world trade system can provide such a discipline by regulating export duties in the same way as it has regulated import duties for the past six decades. That is, to establish the binding of export duties according to the same principles and rules as those applied to import tariffs. The rigid obligations imposed on selected acceding Members do not conform to those norms. Bringing those obligations into the GATT framework would be a first step in the reform of the WTO discipline on export restraints.

Appendix

Status of Export Duty Obligations of WTO Members

	WTO member (year of Accession)	Obligation to eliminate export duties	Obligation to bind export duties at specific rates (including 0 %)	Availability of GATT policy exceptions	Amendability of export duty obligations
1st tier	140+ members	No	No	n/a	n/a
2nd tier	Australia[a]	Yes (on a dozen types of minerals)	No	Yes (GATT schedule)	Yes
	Russia (2012)[b]	No	Yes (over 700 tariff lines)	Yes (GATT schedule)	Yes
3rd tier	Vietnam (2007)[c]	No	Yes (8 products)	Yes (specific reference to GATT)	No
	Ukraine (2008)[d]	No	Yes (over 70 types of products)	Yes (specific reference to GATT exceptions)	No

(continued)

	WTO member (year of Accession)	Obligation to eliminate export duties	Obligation to bind export duties at specific rates (including 0 %)	Availability of GATT policy exceptions	Amendability of export duty obligations
4th tier	Mongolia (1997)[e]	Yes (on raw cashmere)	No	No	No
	Latvia (1999)[f]	Yes (on over 50 products)	Yes (specific antiques)	No	No
	China (2001)[g]	Yes (on all except 84 products)	Yes (84 products)	No	No
	Saudi Arabia (2005)[h]	Yes (on iron and steel scrap)	No	No	No
	Montenegro (2012)[i]	Yes (on all products)	No	No	No

[a]Australia's Uruguay Round Goods Schedules, AUS1-201 through AUS1-204, at http://www.wto.org/english/thewto_e/countries_e/australia_e.htm
[b]The Working Party Report on the Accession of the Russian Federation to the World Trade Organization, WT/ACC/RUS/70 (17 November 2011), para. 638; GATT Schedule CLXV, The Russian Federation, Part V–Export Duties, WT/ACC/RUS/70/ADD.1 (17 November 2011)
[c]Report of the Working Party on the Accession of Viet Nam, WT/ACC/VNM/48 (27 October 2006), para. 260 and Table 17
[d]Report of the Working Party on the Accession of Ukraine to the World Trade Organization, WT/ACC/UKR/152 (25 January 2008), para. 240, and Table 20(b)
[e]Report of the Working Party on the Accession of Mongolia, WT/ACC/MGN/9 (27 June 1996), para. 24
[f]Report of the Working Party on the Accession of Latvia to the World Trade Organization, WT/ACC/LVA/32 (30 September 1998), para. 69; Annex 3
[g]Protocol on the Accession of the People's Republic of China, WT/L/432 (10 November 2001), para. 11.3; Annex 6
[h]Report of the Working Party on the Accession of the Kingdom of Saudi Arabia to the World Trade Organization, WT/ACC/SAU/61 (1 November 2005), para. 184
[i]Report of the Working Party on the Accession of Montenegro to the World Trade Organization, WT/ACC/CGR/38 (5 December 2011), para. 132

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Part III
Free Trade Agreements and Natural Resources

Chapter 8
Free Trade Agreements and Natural Resources

Junji Nakagawa

Abstract This chapter focuses on the provisions of FTAs on natural resources. Natural resources have several unique economic characteristics, including their uneven geographical distribution, exhaustibility and market volatility, and these characteristics often motivate policy intervention in trade and investment in natural resources, such as export taxes, export restrictions and subsidies. As the rules of the WTO law are inadequate in disciplining some of these policy interventions, some FTAs try to fill the gap through trade- and/or investment related provisions focusing on natural resources. The chapter explores the compatibility of such provisions of FTAs on natural resources with the WTO law, and their implications in international trade and investment law. Rather than conducting a comprehensive survey, it takes up several FTAs in the Asia Pacific region that has specific chapters on energy and mineral resources. Finally, it analyzes provisions of the TPP (Trans-Pacific Partnership) on fisheries subsidies.

Keywords Free trade agreements (FTAs) • Natural resources • Export restrictions • Export taxes • Fisheries subsidies • Trans-Pacific Partnership (TPP)

1 Introduction

Natural resources[1] have several unique economic characteristics that requires special treatment in the regulation of their international trade and investment. One is their uneven geographical distribution. Many natural resources are concentrated in a small number of countries, while other countries have limited supplies. While this results in international trade in natural resources from resource rich countries to resource poor countries, it can also cause conflict among them, as some

[1]In this chapter, we define natural resources as "stocks of materials that exist in the natural environment that are both scarce and economically useful in production or consumption, either in their raw state or after a minimal amount of processing". See WTO (2010), p. 46.

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_8

natural resources are indispensable to human life and economic development. In contrast to many trade disputes in manufactured products that are caused by import restrictions, trade disputes in natural resources tend to be caused by export restrictions of resource rich countries. The rules of the WTO law, however, do not discipline export restrictions adequately, because the focus of the WTO law is on import trade, not on exports. Thus, while import tariffs are bound under Article II.1 (b) of the GATT 1994, exports are not subject to such binding.[2] Hence, there is a need for disciplining export policies, notably export taxes, of natural resources through FTAs that are concluded between a resource exporting country and a resource importing country.

Secondly, some natural resources are renewable and others are non-renewable. Examples of renewable natural resources are fish and forests. Examples of non-renewable natural resources are fossil fuels and other mineral resources. As they are non-renewable, they are exhaustible. However, it must be noted that renewable resources may be exhausted if their management is flawed, for instance, overfishing. Exhaustibility of natural resources may justify their export restriction for conservation purposes. Article XX(g) of the GATT 1994, therefore, allow Members to apply export restriction measures "relating to the conservation of exhaustible natural resources", on condition that "such measures are made effective in conjunction with restrictions on domestic production or consumption". From the viewpoint of importing countries, this may motivate them to secure stable supply of exhaustible natural resources through FTAs with exporting countries.

Thirdly, extraction and consumption of natural resources may have negative impacts on the environment. A notable example is the emission of CO_2 from the combustion of fossil fuels that leads to global warming. Another example is the "tragedy of the commons",[3] where the lack of ownership rights over a common pool of resource leads to depletion of that resource. Fisheries in the high seas, for instance, may lead to overfishing unless there exists effective fisheries management system. While environmental externalities have generally been dealt with through multilateral or regional environmental agreements, some recent FTAs tackle with them through the provisions for sustainable management of natural resources. A notable example is the provisions of the TPP (Trans-Pacific Partnership) on fisheries subsidies.

This chapter analyzes these provisions on natural resources in recent FTAs from the viewpoint of, first, their compatibility with the WTO law, and, secondly, their legal implications in international trade and investment law. Rather than conducting a comprehensive survey, this chapter focuses on FTAs in the Asia Pacific region. Section 2 analyzes the provisions of the NAFTA on trade in energy resources, as it was one of the early FTAs in the region that dealt with natural resources. Section 3 analyzes provisions of two EPAs (Economic Partnership Agreements) that Japan

[2] On the discipline of export duties under the rules of the WTO, see the contribution of Gabrielle Marceau in this volume, *infra* Chapter XX.

[3] See Hardin (1968).

concluded with resource exporting countries in the region. Section 4 analyzes the provisions of the TPP on fisheries subsidies. Section 5 concludes.

2 NAFTA and Trade in Energy Resources

The NAFTA (North American Free Trade Agreement) was one of the early FTAs in the Asia-Pacific region that explicitly dealt with trade in energy resources. Most of the energy trade among NAFTA parties flows from Canada and Mexico to the US. Consequently, Canada and Mexico were primarily concerned with ensuring access to the US energy market, while the US sought to increase security of its energy supplies from these countries.[4] Mexico nationalized its petroleum sector in 1938 and Article 27 of its Constitution of 1917 provided for the state ownership of its petroleum resources.[5] Pemex (Petróleos Mexicanos), a state enterprise, monopolized the petroleum sector of Mexico. Mexico, therefore, took a defensive position in the energy sector during the negotiation of the NAFTA, which was coined as "five nos": (1) no foreign investment in the petroleum sector, (2) no risk-sharing contracts with payment in kind with foreign companies, (3) no energy supply commitments, (4) no liberalization of gas imports and exports, and (5) no foreign retail gasoline outlets.[6] Eventually, Mexico managed to defend its negotiating position by refuting requests for investment and market access in its energy sector by the US and Canada. Chapter 6 of the NAFTA, titled Energy and Basic Petrochemicals, set out basic principles for streamlining trade in energy sector, with a broad carve-outs applied to Mexico.

2.1 NAFTA Chapter 6: Energy and Basic Petrochemicals

Chapter 6 of the NAFTA belongs to "Part Two: Trade in Goods" of the Agreement. It largely draws on the Chapter 9 of the Canada-US FTA, titled "Trade in Energy", both in its substance and structure.[7] It consists of nine articles and five annexes, as follows.

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[4]See Rios Herrán and Poretti (2012), pp. 340–41.

[5]Article 27, paragraph 4 provides that "[i]n the Nation is vested the direct ownership of … petroleum and all solid, liquid, and gaseous hydrocarbons; …". The English translation of the text of the Mexican Constitution of 1917 is available at http://www.latinamericanstudies.org/mexico/1917-Constitution.htm. Accessed 31 January 2016.

[6]See Rios Herrán and Poretti (2012), pp. 343–44.

[7]The text of the Canada-US FTA is available at http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/cusfta-e.pdf. Accessed 31 January 2016. Chapter 9 consists of nine articles, as follows. Article 901: Scope, Article 902: Import and Export Restrictions, Article 903: Export Taxes, Article 904: Other Export Measures, Article 905: Regulatory and Other

Article 601: Principles
Article 602: Scope and Coverage
Article 603: Import and Export Restrictions
Article 604: Export Taxes
Article 605: Other Export Measures
Article 606: Energy Regulatory Measures
Article 607: National Security Measures
Article 608: Miscellaneous Provisions
Article 609: Definitions
Annex 602.3: Reservations and Special Provisions
Annex 603.6: Exception to Article 603
Annex 605: Other Export Measures
Annex 607: National Security Measures
Annex 608.2: Other Agreements

2.1.1 General Principles and Scope

Article 601 lists three general principles governing trade in energy and basic petrochemicals. The first is the Parties' confirmation of the full respect for their Constitutions (Article 601.1). As there is no such principle in Chapter 9 of the Canada-US FTA, this was added at the demand of Mexico, and provided for the legal ground for its exemptions and exceptions from the rules contained in Chapter 6.[8]

Article 601 provides for two more principles, namely, the desirability of strengthening the important role that trade in energy and basic petrochemical goods plays in the free trade area and to enhance this role through sustained and gradual liberalization (Article 601.2), and the importance of having viable and internationally competitive energy and petrochemical sectors to further their individual national interests (Article 601.3). The idea of gradual liberalization expressed in the second principle underscores the unfinished nature of the NAFTA in trade in energy and basic petrochemical sectors, as Mexico's carve-outs were expected to be lifted in the future.[9]

Article 602.1 describes the scope of the Chapter as follows:

> This Chapter applies to measures relating to energy and basic petrochemical goods originating in the territories of the Parties and to measures relating to investment and to the cross-border trade in services associated with such goods, as set forth in this Chapter.

Article 602.1 is complemented by Article 602.2, which defines "energy and basic petrochemical goods" according to the tariff classifications under the Harmonized

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Measures, Article 906: Government Incentives for Energy Resource Development, Article 907: National Security Measures, Article 908: International Obligations, and Article 909: Definitions.

[8] See Rios Herrán and Poretti (2012), pp. 356–57.

[9] See *ibid*., p. 357.

System (HS), covering practically all forms of energy.[10] However, it does not cover products made from petroleum that serve purposes other than energy, including the production of plastics, etc., which falls under HS Code 29 (organic chemicals).

Although it refers to investment and trade in services in energy and basic petrochemicals, the provisions of Chapter 6 deal with trade in goods, and investment and trade in services are covered by Chapter 11 and Chapter 12, respectively.

While the broad scope of Chapter 6 is applied for Canada and US, the scope of Chapter 6 is much narrower for Mexico. According to paragraph 1(a) and 1(b) of Annex 602.3, Mexico reserves to itself the following activities: (1) exploration and exploitation of crude oil and natural gas, refining or processing of crude oil and natural gas, and production of artificial gas, basic petrochemicals and their feedstocks and pipelines, and (2) foreign trade, transportation, storage and distribution, up to and including the first hand sales of crude oil, natural and artificial gas, goods obtained from the refining or processing of crude oil and natural gas, and basic petrochemicals. This means that the entire hydrocarbons sector remains in the hands of Mexico through Pemex.[11] Mexico also reserves to itself the supply of electricity as a public service (Annex 602.3, para.1(c)), and nuclear energy sector (Annex 602.3, para.1(d)).[12]

Substantive rules of Chapter 6 are divided into two groups. The first group, consisting of Articles 603 and 604, prohibits or limits the use of restrictive measures in imports and exports. The second group, consisting of Articles 605 and 607, disciplines the Parties' use of trade restrictive measures under exceptional circumstances.

2.1.2 Import and Export Restrictions and Export Taxes

Article 603.1 incorporates GATT provisions with respect to the prohibition of restrictions on import and export of energy and basic petrochemical goods. Article 603.2 provides that:

> The Parties understand that the provisions of the GATT incorporated in paragraph 1 prohibit ... minimum or maximum export-price requirements and ... minimum or maximum import-price requirements.

Article 603.2 thus adds to Article XI.1 of the GATT on general elimination of quantitative restrictions, as the latter allows minimum or maximum export- or

[10] They are HS subheadings 2612.10, 27.01 through 27.06, 2707.50, 2707.99, 27.08 and 27.09, 27.10, 27.11, 27.12 through 27.16, 2844.10 through 2844.50, 2845.10, and 2901.10.

[11] See Rios Herrán and Poretti (2012), pp. 358–59.

[12] Annex 602.3, para.5 enlists three exceptions to this reservation. Foreign investment is allowed in (1) generation of electricity for own use of an enterprise, (2) co-generation of electricity using energy sources associated with an industrial process, and (3) independent power production (IPP). The surplus electric power, however, shall be sold to the CFE (Comisión Federal de Electricidad), a Mexican state-owned electricity enterprise. See Annex 602.3, para.5.

import-price requirements. By prohibiting such price requirements, Article 603.2 aims at prohibiting the so-called "dual pricing" practice, whereby a Party segments its domestic market by maintaining domestic prices lower than export prices.[13] Mexico was exempt from this obligation for most energy goods.[14]

Article 603.5 allows Parties to administer a system of import and export licensing for energy or basic petrochemical goods, on condition that it is consistent with the Agreement. Specifically, it refers to Article 603.1 above, and Article 1502 (Monopolies and State Enterprise).[15] Here again, Mexico reserved the right to conduct foreign trade of hydrocarbon products through its state monopoly Pemex.[16]

Article 604 prohibits Parties to adopt or maintain "any duty, tax or other charge on the export of energy or basic petrochemical good", unless such duty, tax or charge is adopted or maintained on (1) exports of such good to all other Parties, and (2) they are applied to any such good when they are destined for domestic consumption. As there is no Annex to this Article, it is also applied to Mexico.

2.1.3 Other Export Measures and National Security Measures

Article 605 aims at strengthening the disciplines for the Parties' right to conduct export restrictions in exceptional circumstances under the GATT. Under the GATT, Members are allowed to conduct export restrictions of goods, including energy and basic petrochemical goods, in the following four circumstances: (1) in the event of critical shortage (Article XI.2(a)), (2) relating to the conservation of exhaustible natural resources (Article XX(g)), (3) involving restrictions on exports of domestic materials necessary to ensure essential quantities of such 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 governmental stabilization plan (Article XX (i)), or (4) essential to the acquisition or distribution of products in general or local short supply (Article XX(j)). Article 605 sets three additional conditions to the use of these rights of export restrictions, which are applied cumulatively. First, the restriction shall not result in a reduction of exports as a percentage of total supply. The proportion of exports to a Party in the most recent 36 month period for which data are available prior to the imposition of the measure is used as a benchmark.[17] This is called the proportionality clause.[18] Secondly, the Party shall not impose a higher price for the exports of an energy or basic petrochemical good to the other

[13] See Rios Herrán and Poretti (2012), p. 360.

[14] See Annex 603.6.

[15] Article 1502 allows Parties to designate monopolies. Monopolies, however, shall "act solely in accordance with commercial considerations in the purchase or sale of the monopoly good or service". See Article 1502.3(b).

[16] See Annex 603.6.

[17] See Article 605(a).

[18] See Watkins (1999), pp. 5–6.

Party than the price charged for such good when consumed domestically.[19] This obligation, together with Article 603.2, precludes the Parties from adopting or maintaining "dual price" system. Thirdly, the restriction shall not disrupt "normal channels" of supply.[20] As Mexico is exempt from these obligations,[21] the most plausible case of the application of Article 605 will be for US to challenge a restriction imposed by Canada on export of crude oil or natural gas.[22]

Finally, Article 607 sets additional conditions to the Parties' right to apply import or export restriction of an energy or basic petrochemical good for a national security. It denies the application of Article XXI of the GATT and Article 2102 of the NAFTA (National Security), and allows Parties' to apply such measure except to the extent necessary to (1) supply a military establishment of a Party or enable fulfillment of a critical defense contract of a Party, (2) respond to a situation of armed conflict involving the Party taking a measure, or, (3) respond to direct threats of disruption in the supply of nuclear materials for defense purpose. Here again, Mexico is exempt from this obligation, and Article 2102 of the NAFTA shall apply as between Mexico and the other Parties.[23]

2.2 Legal Implications of the NAFTA Chapter 6

NAFTA Chapter 6 has a number of GATT-plus provisions. First, Article 603.2 adds to GATT Article XI on general elimination of quantitative restriction by eliminating minimum or maximum export- or import-price requirements. Secondly, while export taxes are allowed under the GATT, Article 604 prohibit Parties to impose export taxes on energy and basic petrochemical goods except those which are also applied to goods for domestic consumption. Thirdly, Article 605 makes the use of several GATT-consistent exemptions conditional on the fulfillment of three cumulative conditions. Fourthly, Article 607 adds to GATT Article XXI (and NAFTA Article 2102) by narrowly specifying the import or export restriction measures allowed for national security reasons. These GATT-plus provisions aim at securing access to energy resources by constraining the Parties' right to restrict exports of energy and basic petrochemical goods. These provisions are legally binding, and the dispute settlement procedure under NAFTA Chapter 20 is applied to the disputes on the interpretation and application of Chapter 6, though there has so far been no dispute cases under Chapter 6.

It must be noted, however, that NAFTA Chapter 6 was practically a bilateral agreement between Canada and the US, as Mexico was exempted from most of the

[19]See Article 605(b).

[20]See Article 605(c).

[21]See Annex 605.

[22]See Rios Herrán and Poretti (2012), pp. 364–66.

[23]See Annex 607.

obligations under Chapter 6. State monopoly of energy resources was a constitutional principle that was maintained since the nationalization of petroleum sector in 1938. Although Mexico made substantive "payments" for preferential access to the markets of Canada and the US, including government procurement, trade in services and intellectual property rights, it could successfully defend the energy sector by making little commitment under Chapter 6.

2.3 Mexico's Energy Sector Reform

On December 20, 2013, Mexican President Enrique Peňa Nieto signed an amendment to the Constitution, whereby the state monopoly in the exploration and exploitation of hydrocarbon resources was finally eliminated. Key elements of the reform consist of the following.[24]

Maintaining state ownership of subsoil hydrocarbons resources, but allowing companies to take ownership of those resources once they are extracted;
Creating four types of contracts for exploration and exploitation: services contracts, profit-sharing contracts, production-sharing contracts, and licenses;
Opening refining, transport, storage, natural gas processing, and petrochemicals sectors to private investment; and
Abolishing the state monopoly in electricity sector, and private power generators will be able to sell electricity to large-scale customers either directly or through the wholesale market of electricity.

In August 2014, the Mexican Congress passed secondary laws to implement the constitutional amendment of December 2013. Key provision are as follows.[25]

Pemex is more independent of the state, but must adopt internal reforms;
Pemex is permitted to keep some of its existing oil fields through a "Round Zero" process as deemed appropriate by the Secretariat of Energy; and
Pemex's monopoly on retail gasoline and diesel sales ends in 2016.

In August 2014, the government of Mexico announced the result of "Round Zero", awarding 83 % of Mexico's probable reserves to Pemex.[26] It also announced the outline of "Round One", whereby reserves will be open to private firms incorporated in Mexico.[27] In December 2014, the government of Mexico announced the terms under which private firms could bid on production-sharing

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[24]See Seelke et al. (2015), p. 4.
[25]See *ibid*., p. 5.
[26]Probable reserves are those which have a 50 % chance of being present. See Society of Petroleum Engineers, Petroleum Reserves Definitions. Available at http://www.spe.org/industry/petroleum-reserves-definitions.php. Accessed 31 January 2016.
[27]See Seelke et al. (2015), p. 7.

contracts in "Round One". In July 2015, the bidding results were announced, with 2 out of the 14 blocks available were awarded.[28]

As a result of these reforms, Mexico eventually opened its energy sector to foreign investors. These reforms were reflected in the Sect. 2, Annex II of the TPP, Schedule of Mexico, as follows.

> Mexico allows private investment exclusively through contractual arrangements with respect to the exploration and production of oil and other hydrocarbons, and the public service of transmission and distribution of electricity.[29]

3 Japan's EPAs and Energy and Mineral Resources

Japan is one of the largest importers of natural resources, particularly energy and mineral resources. Securing stable supply of these resources has been one of the priority goals of Japan's EPA strategy. It has concluded three EPAs with resource exporting countries that have specific chapters on energy and mineral resources, namely, Japan-Brunei EPA,[30] Japan-Indonesia EPA[31] and Japan-Australia EPA.[32] This section will analyze the chapters on energy and mineral resources of the latter two EPAs.

3.1 Japan-Indonesia EPA and Energy and Mineral Resources

Indonesia is Japan's major supplier of crude oil, coal and liquefied natural gas (LNG). Chapter 8 of the Japan-Indonesia EPA covers energy and mineral resources. Its aim is to secure the stable supply of energy and mineral resources through promoting investment and trade in these resources. It also aims at enhancing bilateral cooperation in energy and mineral resources sector. It consists of the following nine articles.

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[28]See id.

[29]The text of the TPP is available at either https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text or https://www.mfat.govt.nz/en/about-us/who-we-are/treaty-making-process/trans-pacific-partnership-tpp/text-of-the-trans-pacific-partnership. Accessed 31 January 2016.

[30]Signed June 15, 2007, entered into force 31 July 2008.

[31]Signed August 10, 2007, entered into force 1 July 2008. Its English text is available at http://www.mofa.go.jp/region/asia-paci/indonesia/epa0708/index.html. Accessed 31 January 2016.

[32]Signed 8 July 2014, entered into force 15 January 2015. Its English text is available at http://www.mofa.go.jp/ecm/ep/page22e_000430.html. Accessed 31 January 2016.

Article 97: Definitions
Article 98: Promotion and Facilitation of Investment
Article 99: Import and Export Restrictions
Article 100: Export Licensing Procedures and Administrations
Article 101: Energy and Mineral Resource Regulatory Measures
Article 102: Environmental Aspects
Article 103: Community Development
Article 104: Cooperation
Article 105: Sub-Committee on Energy and Mineral Resources

3.1.1 Scope

The scope of Chapter 8, namely, "energy and mineral resources" are defined by Annex 11 of the Japan-Indonesia EPA. In addition to energy resources such as crude oil, coal and LNG, mineral resources such as copper and nickel are covered by the chapter.

3.1.2 Import and Export Restrictions

On import and export restrictions of energy and mineral resources, Article 99.1 reaffirms the Parties' obligations to comply with the relevant provisions of the GATT 1994. This refers to Articles XI.1 (general elimination of quantitative restrictions), XI.2(a) (critical shortage), XX(g) (conservation of exhaustible natural resources), XX(i) (price stabilization), and XX(j) (short supply). Article 99.2 sets out procedural requirements in import and export restrictions. Each Party, when introducing a prohibition or restriction of imports or exports otherwise justified under the relevant provisions of the GATT 1994, shall provide relevant information concerning such prohibition or restriction as early as possible to the other Party. It shall also reply, upon the request of the other Party, to specific questions on such prohibition or restriction from the other Party, with a view to avoiding disruption of ordinary business activities in the Parties. Although Article 99 provides for rules for both import and export restrictions, it practically sets out rules for export restrictions, as there's little possibility for the Parties to apply import restrictions on energy and mineral resources.

Article 100 provides for rules on the procedure and administration of export licensing. First, the rules for export licensing procedures shall be neutral in application and administered in a fair and equitable manner (Article 100(a)). Secondly, detailed rules for the export licensing procedures shall be published as soon as possible, in such a manner as to enable the other Party and traders of the other Party to become acquainted with them (Article 100(b)), and the Party shall hold consultations un the rules with the other Party upon the request of the other Party (Article 100(g)). Thirdly, in the case of licensing requirements for purposes other than the implementation of quantitative restrictions, the Party

shall publish sufficient information on the basis for granting and/or allocating licenses (Article 100(c)). Fourthly, where the Party provides the possibility for the persons of the other Party to request exceptions or derogations from a licensing requirement, it shall include this fact in the detailed rules to be published under paragraph (b) above, as well as information on how to make such a request and, to the extent possible, an indication of the circumstances under which such a request would be considered (Article 100(d)). Fifthly, upon the request of the other Party, the Party shall provide all relevant information concerning the administration of the restrictions (Article 100(e)). Sixthly, when administering quotas by means of export licensing, the Party shall inform the other Party of the overall amount of quotas to be applied and any change thereof (Article 100(f)). Seventhly and finally, any person of the other Party which fulfills the legal and administrative requirements of the former Party shall be equally eligible to apply and to be considered for a license. If the license application is not approved, the applicant of the other Party shall, on request, be given the reason thereof and shall have a right of appeal or review (Article 100(h)). It is worth noting that the last provision gives the applicant of the other Party a private right of action, including the right to ask for the reason of disapproval of its application and the right of appeal or review. In sum, Article 100 sets out detailed procedural requirements for the exporting Party, or Indonesia, in the design and administration of export licensing, while it reaffirms the Party's right of introducing and maintaining export licensing under the GATT 1994.

3.1.3 Promotion and Facilitation of Investment

Chapter 5 of the Japan-Indonesia EPA provides for the general rules for the protection and promotion of foreign investment between Japan and Indonesia. Chapter 8 provides for additional rules for the promotion and facilitation of investment in the energy and mineral resources sector. Article 98 provides for cooperative activities to be taken by the Parties. Both Parties shall cooperate in promoting and facilitating such investment through ways such as (1) discussing effective ways on investment promotion activities and capacity building, (2) facilitating the provision and exchange of investment information including information on the laws, regulations and policies of the Parties, (3) encouraging and supporting investment promotion activities of the Parties relating to, in particular, the exploration, exploitation and production of energy and mineral resource goods and the infrastructural facilities in the sector, and (4) discussing effective ways of creating stable, equitable, favorable and transparent conditions for investors (Article 98.1.(a)). Annex 12 of the Japan-Indonesia EPA sets out one more cooperative activity between the Parties for the promotion and facilitation of investment. It provides that, upon request of either Party, the Parties shall consult on risk sharing

measures[33] to support investments by Japanese investors in the energy and mineral resource sector of Indonesia. Japanese investment in energy and mineral resources sector of Indonesia is conducted by Japanese private firms. Therefore, these provisions aim at nurturing a favorable environment for the promotion and facilitation of investment mainly through discussion and exchange of information between the Parties, rather than directly obliging the Parties to take active measures.

3.1.4 Environment and Community Development

Investment in energy and mineral resources sector may have harmful environmental impacts. Such investment may also have social impacts on the local community at the location of its investment, such as job creation and human resource development. Chapter 8 contains a couple of provisions dealing with such social impacts of investment in energy and mineral resources sector. First, Article 102 provides that each Party confirms the importance of avoiding or minimizing harmful environmental impacts of all activities related to energy and mineral resources in its territory (Article 102.1). The measures to be taken are, however, rather modest ones. Each Party shall (1) take account of environmental considerations throughout the process of formulation and implementation of its policy on energy and mineral resources (Article 102.2(a)), (2) encourage favorable conditions for the transfer and dissemination of technologies that contribute to the protection of environment (Article 102.2 (b)), and (3) promote public awareness of environmental impacts of activities related to energy and mineral resources (Article 102.2(c)). On community development, Article 103 provides that each Party welcomes any contribution by investors of the other Party to the development of its community when such investors make investments in the energy and mineral resource sector in its area. This provision is unique in the sense that it addresses private investors, not state Parties, to contribute to community development at the location of their investments.

3.1.5 Energy and Mineral Resource Regulatory Measures

Trade in energy and mineral resources is often conducted through long-term supply contracts. Investment in energy and mineral resources ordinarily spans many years, or even decades from exploration through the termination of commercial production. It is, therefore, important for private firms engaging in trade and investment in these sectors to expect transparent and stable regulatory environment throughout the duration of their business activities. Article 101 provides for several rules to meet this expectation of private firms. First, each Party shall seek to ensure that, in

[33] "Risk sharing measures" means any measures by Indonesia to support investment by Japanese investors relating to infrastructure of Indonesia, of either financial or non-financial nature. See Note to Annex 12, Japan-Indonesia EPA.

the application of any energy and mineral resource regulatory measure, the regulatory authorities of the Party shall avoid disruption of contractual relationships which exist at the time of the application of the measure. It shall also seek to ensure that the regulatory authorities of the Party shall implement the measure in an orderly and equitable manner (Article 101.1). Although these rules are legally binding, their legal effect is limited, as they are phrased as “best effort” obligations, telling each Party to “seek to ensure”, instead of simply “ensure”. Article 101 also sets out procedural requirements. If the energy and mineral resource regulatory bodies of a Party adopt any new regulatory measure, the Party shall notify the other Party or publish the measure as soon as possible, and it shall respond to specific questions on the measure from the other Party (Article 101.2).

3.1.6 Cooperation

Finally, Article 104 provides for cooperation between the Parties in the energy and mineral resources sector of Indonesia. Areas of cooperation include policy development, capacity building and technology transfer (Article 104.3(a)). Forms of cooperation, as set forth in Article 9 of the Implementing Agreement of the Japan-Indonesia EPA, may include (1) encouraging exchange of views and information on laws and regulations, (2) encouraging and facilitating visits and exchanges of experts, (3) encouraging joint studies, workshops and training, and (4) promoting implementation of joint projects and programs. Sub-Committee on Energy and Mineral Resources, to be composed of representatives of the governments of the Parties, shall review and monitor the implementation of Chapter 8, including cooperation, and discuss any issues related to Chapter 8, including cooperation (Article 105).

3.2 Japan-Australia EPA and Energy and Mineral Resources

Australia is Japan’s major supplier of iron ore, coal and natural gas. The Final Report of the joint study for enhancing economic relations between Japan and Australia, including the possibility of an FTA,[34] in its paragraph 37, concluded that it would be feasible to consider provisions to enhance the security of supply of minerals and energy to Japan as part of a comprehensive bilateral EPA/FTA. The study group suggested that a chapter on minerals and energy could include commitments such as,

[34] Joint Study for Enhancing Economic Relations between Japan and Australia, including the Feasibility or Pros and Cons of a Free Trade Agreement, Final Report, December 2006. Available at http://www.mofa.go.jp/region/asia-paci/australia/joint0612.pdf. Accessed 31 January 2016.

(i) Provisions that reinforce the role of the market (for example, by preventing the use of export and import restrictions),
(ii) Investment liberalization and protection provisions that improve the investment environment,
(iii) Measures that promote transparency of policy and regulation with respect to the minerals and energy sector,
(iv) Provisions for a consultation mechanism involving business with respect to issues in the minerals and energy sector, and
(v) Provisions allowing for the review of an EPA/FTA as it applies to the minerals and energy sector.[35]

Chapter 8 of Japan-Australia EPA, titled "Energy and Mineral Resources", covers some of the provisions suggested by the study group but not all of them. It consists of the following eight articles.

Article 8.1: Basic Principle
Article 8.2: Definitions
Article 8.3: Stable Supply of Energy and Mineral Resources
Article 8.4: Export Restrictions
Article 8.5: Export Licensing Procedures and Administrations
Article 8.6: Energy and Mineral Resource Regulatory Measures
Article 8.7: Cooperation
Article 8.8: Sub-Committee on Energy and Mineral Resources

The structure of Chapter 8 of the Japan-Australia EPA is similar to that of Chapter 8 of the Japan-Indonesia EPA, but there are differences in the contents of the rules contained therein.

3.2.1 Scope

The scope of Chapter 8 is defined in Annex 5 of the Japan-Australia EPA. It covers a wide range of energy and mineral resources with HS (Harmonized System) Code Chapters 25 (salt, sulphur, earth and stone, lime and cement), 26 (ores slag and ash), 27 (mineral fuels, oils, waxes and bituminous sub), 28 (rare-earth metals), and several other metals.[36]

3.2.2 Export Restrictions

In contrast to Article 99 of the Japan-Indonesia EPA that is addressed to both import and export restrictions, Article 8.4 of the Japan-Australia EPA is solely addressed to export restrictions. It aims at imposing moderate constraint on the Party's right to

[35] *Ibid.*, pp. 13–14.
[36] They are nickel, aluminium and cobalt.

apply export restrictions on an energy and mineral resources under Articles XI.2 (a) and Article XX(g) of the GATT 1994. First, each Party shall endeavor not to introduce or maintain any prohibitions or restrictions on the exportation of any energy and mineral resource in accordance with these provisions of the GATT 1994 (Article 8.4.1). Secondly, where a Party intends to adopt an export prohibition or restriction on an energy and mineral resource good in accordance with these provisions, it shall (1) seek to limit such prohibition or restriction to the extent necessary, giving due consideration to its possible negative effects on the other Party's energy and mineral resources security (Article 8.4.2(a)), (2) notify, as far in advance as practicable, to the other Party of such measure and its reasons together with its nature and expected duration (Article 8.4.2(b)), and (3) on request, provide the other Party with a reasonable opportunity for consultation with respect to any matter related to such measure (Article 8.4.2(c)).

On export licensing, Article 8.5 of the Japan-Australia EPA sets out detailed rules that are quite similar to those provided by Article 100 of the Japan-Indonesia EPA. First, the implementation of export licensing procedures shall be undertaken in a transparent and predictable manner (Article 8.5(a)). Secondly, detailed rules for the export licensing procedures, as well as any modification thereto, shall be published as soon as possible, in such a manner as to enable the other Party and traders of the other Party to become acquainted with them (Article 8.5(b)). Thirdly, upon the request of the other Party, the Party shall provide all relevant information concerning the administration of the export licensing procedures (Article 8.5(c)). Fourthly, when administering quotas by means of export licensing, the Party shall inform the other Party of the overall amount of quotas to be applied and any change thereof (Article 8.5(d)). Fifthly, upon the request of the other Party, the Party shall hold consultations on the rules for such procedures with the other Party (Article 8.5 (e)). Sixthly and finally, if a license application is not approved, an applicant of the other Party shall, upon request, be given the reason thereof and shall have a right of appeal or review (Article 8.5(f)).

3.2.3 Stable Supply of Energy and Mineral Resources

In contrast to Chapter 8 of the Japan-Indonesia EPA, Chapter 8 of the Japan-Australia EPA does not provide specifically for the promotion and facilitation of investment in energy and mineral resources sector. Instead, it has a broad provision for a stable supply of energy and mineral resources, consisting of two subparagraphs, one is general and the other is procedural. First, the Parties recognize the importance of a stable supply of energy and mineral resources and the role that trade, investment and cooperation (including on infrastructure development) play in achieving long term security, and each Party shall take reasonable measures as may be available to it for that purpose (Article 8.3.1). Secondly, if there arises a severe and sustained disruption to supply of an energy and mineral resource or threat thereof, a Party may request consultations with the other Party. When such a request is made, the other Party shall reply promptly to the request, and start consultations to discuss the matter within a

reasonable period of time after the receipt of the request. The Parties shall endeavor to take any appropriate actions available to them that would contribute to the resolution of the disruption or threat thereof (Article 8.3.2).

It is not clear to what extent these provisions will contribute to securing a stable supply of energy and mineral resources. The first paragraph is, at best, hortatory, as it contains no more than a "best effort" obligation to "take reasonable measures as may be available". On the other hand, the second paragraph enables Japan to request consultation with Australia if it faces a severe and sustained disruption to supply of an energy and mineral resource. This procedural right was one of the provisions suggested by the study group,[37] though it doesn't refer to the involvement of private sector, as suggested by the study group.

On the protection of investment in energy and mineral resources sector, it must be noted that the Japan-Australia EPA does not provide for an investor-state dispute settlement (ISDS) mechanism. Instead, Article 14.6 provides that each Party shall accord to investors of the other Party access to its courts of justice and administrative tribunals. This may be a potential source of instability to Japan's investment to Australia, including those in energy and mineral resources sector. However, the situation may be changed as a result of the TPP, because Australia accepted an ISDS mechanism in the chapter on investment of the TPP. Accordingly, when the TPP enters into force, Japan's investors to Australia will be able to resort to the ISDS mechanism of the TPP, or Japan and Australia may review the Japan-Australia EPA with a view to establishing an ISDS under the EPA.[38]

3.2.4 Energy and Mineral Resource Regulatory Measures

Article 8.6 of the Japan-Australia EPA contains both substantive rules and procedural rules on regulatory measures in energy and mineral resources, which are similar to those provided by Article 101 of the Japan-Indonesia EPA. However, there are a few differences between them. As a substantive rule, Article 8.6.1 provides that, in the introduction of any energy and mineral resource regulatory measure of general application, a Party shall (1) take into consideration the impact on commercial activities, and (2) implement such measure in an orderly and equitable manner in accordance with its laws and regulations. While the latter obligation is almost identical to that of Article 101 of the Japan-Indonesia EPA, the former obligation is weaker than that of Article 101, as Article 101 provides that the regulatory authorities of the Party shall avoid disruption of contractual relationships which exist at the time of the application of the measure.

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[37]See item (iv) of the provisions suggested by the study group, in Sect. 3.2 of this chapter.

[38]See Article 14.19.2 of the Japan-Australia EPA, which provides that the Parties shall conduct a review of the Chapter 14 if Australia enters into any multilateral or bilateral international agreement providing for an ISDS mechanism, with a view to establishing an equivalent mechanism under the Japan-Australia EPA.

On the other hand, procedural rules of Article 8.6 are more detailed and stringent than those of Article 101 of the Japan-Indonesia EPA. First, upon request of a Party, the other Party shall promptly provide information and respond to questions related to any new energy and mineral resources regulatory measure of general application (Article 8.6.2). Secondly, in cases where a Party adopts any new energy and mineral resources regulatory measure of general application that might materially affect the operation of Chapter 8 or otherwise substantively affect the other Party's interests under Chapter 8, the Party shall (1) notify the other Party of such measure prior to its implementation, or as soon as possible thereafter (Article 8.6.3), and (2) hold consultations with the other Party, upon request of the other Party (Article 8.6.4).

3.2.5 Cooperation

In contrast to Article 104 of the Japan-Indonesia EPA, the Japan-Australia EPA has a very simple provision on cooperation. Article 8.7 provides that the Parties shall promote cooperation for strengthening stable and mutually beneficial relationships in the energy and mineral resources sector. This is partly because the Japan-Australia EPA is a FTA between developed countries and there is no need of capacity building activities. Also, this is partly because the other provisions in Chapter 8 set out specific forms of cooperation, namely, notification, information exchange and consultation.

4 Provisions of the TPP on Fisheries Subsidies

Article 20.16 of the TPP, titled "Marine Capture Fisheries", sets out unique disciplines on fisheries subsidies from the viewpoint of the conservation and the sustainable management of marine fisheries resources. This is the first provision in a trade agreement that aims at sustainable management of fisheries resources by disciplining fisheries subsidies. Trade regime and fisheries resources conservation regime were, until recently, two separate regimes with different scopes and with different sets of rules and procedures. The Doha Ministerial Declaration, however, changed the situation by declaring the launch of negotiation to "improve and clarify the WTO discipline on fisheries subsidies" within the framework of Doha negotiation on rules.[39] This section briefly traces the Doha negotiation on fisheries subsidies and analyzes the provisions of the TPP on fisheries subsidies.

[39]Doha Ministerial Declaration, 14 November 2001, para.28. Available at https://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm. Accessed 31 January 2016.

4.1 The Doha Negotiations on Fisheries Subsidies

4.1.1 Disciplining Fisheries Subsidies Before the Doha Negotiations

There is a wide consensus among scientists that one of the factors that threaten the sustainability of fisheries stocks is fishing overcapacity.[40] As there grew an awareness of that there is too much fishing capacity in marine fisheries, economists have shown that government practices including fisheries subsidies contribute to inadequate incentives for vessel production that results in fishing overcapacity.[41] As fisheries subsidies, or at least some of them, contribute to fishing overcapacity, a number of regimes came to restrain fisheries subsidies in the 1990s,[42] including the International Plan of Action for the Management of Fishing Capacity (IPOA-Capacity),[43] sponsored by the FAO (Food and Agriculture Organization of the United Nations). The IPOA-Capacity advised individual states to develop national plans for the management of fishing capacity, and provided that "(s)tates should assess the possible impact of all factors, including subsidies, contributing to overcapacity on the sustainable management of their fisheries, distinguishing between factors, including subsidies, which contribute to overcapacity and unsustainability and those which produce a positive effect or are neutral".[44] The legal effect of this provision was, however, limited for the two reasons. First, the IPOA-Capacity was not legally binding. Secondly, the provision advised states to assess the impact of fisheries subsidies on overcapacity, rather than eliminating them.

4.1.2 Negotiations on Fisheries Subsidies Before the Doha Ministerial Conference

After the establishment of the WTO, the Committee on Trade and Environment (CTE) began discussions on the role that subsidies play in the fisheries sector. The CTE conducted an analysis of the rules of the GATT and WTO on fisheries subsidies.[45] It then moved on to the discussion on the impact of fisheries subsidies on sustainable fisheries. Australia, US, Iceland, New Zealand and the Philippines led the discussion at the CTE, alleging that fisheries subsidies may have negative

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[40]See Young (2011), p. 87.

[41]*Ibid.*, p. 87–88.

[42]For an overview of international regimes on fisheries subsidies, see Nakagawa (2010), pp. 36–40. Also see Chen (2010), pp. 18–28.

[43]FAO, International Plan of Action for the Management of Fishing Capacity, adopted by the FAO Committee on Fisheries in February 1999 and endorsed by the FAO Council in June 1999. Its text is available at ftp://ftp.fao.org/docrep/fao/006/x3170e/X3170E00.pdf, pp. 19–26. Accessed 31 January 2016.

[44]*Ibid.*, para.25.

[45]See WTO Committee on Trade and Environment, GATT/WTO Rules on Subsidies and Aids Granted in the Fishing Industry, Note by the Secretariat, WT/CTE/W/80, 9 March 1998.

impact on sustainable fisheries and that such subsidies should be eliminated.[46] In October 2000, the WTO Secretariat submitted a Note to the CTE, which emphasized that the removal of environmentally-harmful subsidies would represent a necessary step towards eliminating an economic obstacle hampering the achievement of sustainable fisheries management.[47] Based on these analyses and discussions at the CTE, the Members of the WTO agreed to take up the issue of disciplining fisheries subsidies at the Doha negotiation, as declared in the Doha Ministerial Declaration.

4.1.3 The Doha Negotiations on Fisheries Subsidies and Its Achievement

Two main positions were taken by the Rules Group participants.[48] One was taken by an informal group of WTO Members self-named "Friends of Fish".[49] They proposed a general prohibition of fisheries subsidies with limited exceptions, including those which are expressly not aimed at encouraging overfishing. The other position was taken by Japan, Korea and Taiwan. They asserted that inadequate fisheries management is the main cause of unsustainable fishing and that subsidies do not contribute to overfishing if fisheries are adequately managed. They thus persistently opposed to the general prohibition of fisheries subsidies proposed by the Friends of Fish. The discussions culminated in a draft legal text on fisheries subsidies, presented by the Chairman of the WTO Negotiating Group on Rules in November 2007 (hereinafter referred to as "Chair's text").[50]

The Chair's text adopted an eclectic discipline on fisheries subsidies, reflecting the conflicting positions of the two groups. First, reflecting the position of Japan, Korea and Taiwan, Article I.1 of the Chair's text listed prohibited specific categories of fisheries subsidies. However, reflecting the position of the Friends of Fish, the coverage of prohibited subsidies was wider than those proposed by Japan, Korea

[46]See, for instance, Australia, Iceland, New Zealand, the Philippines and the US, Joint Statement titled "Promote Sustainable Development by Eliminating Trade Distorting and Environmentally Damaging Fisheries Subsidies", issued at the High Level Symposia on Trade and Development and Trade and Environment in March 1999, reproduced in Annex I of WT/CTE/W/12s, 28 June 1999, pp. 6–7.

[47]See WTO Committee on Trade and Environment, Environmental Benefits of Removing Trade Restrictions and Distortions: The Fisheries Sector, Note by the Secretatiat, WT/CTE/W/167, 16 October 2000, papra.37–47.

[48]See Nakagawa (2010), pp. 41–44 on the details of the negotiations. Also see Chen (2010), Chapter 2.

[49]Members of the "Friends of Fish" included Australia, Chile, Ecuador, Iceland, New Zealand, Peru, Philippines and the US.

[50]WTO Negotiating Group on Rules, Draft Consolidated Text of the AD and SCM Agreements, Annex VIII Fisheries Subsidies, TN/RL/W/213, 30 November 2007, pp. 87–93.

and Taiwan.[51] Secondly, reflecting the position of the Friends of Fish, Article I.2 generally prohibited any subsidy on any fishing vessel or fishing activity affecting fish stocks that are in an unequivocally overfished condition. Thirdly, Article II set out general exceptions to the prohibited subsidies but they are narrower than both those asserted by the Friends of Fish and Japan, Korea and Taiwan.[52] The Chair's text set out additional obligations to those subsidies allowed under Article II. Article V.1 provides that any Member granting or maintaining any subsidy as referred to in Article II shall operate a fisheries management system, within its jurisdiction, designated to prevent overfishing. Article VI.1 provides that each Member shall notify to the Committee on Subsidies and Countervailing Measures any measure for which that Member invokes Article II. Finally, for those prohibited subsidies Article VII.2 set out a grace period of 2 years from the entry into force of the result of the Doha negotiations for developed country Members. This was in contrast to both positions of the Friend of Fish, who asserted a grace period of 3 years and Japan, Korea and Taiwan, who asserted a 6-year grace period.

The Chair's text was criticized by both groups. The Friends of Fish criticized that the category of prohibited subsidies was too narrow, while Japan, Korea and Taiwan criticized that it was too wide. With respect to the general exceptions to the prohibited subsidies provided by the Chair's text, Japan, Korea and Taiwan criticized that they were too narrow and that the conditions for their eligibility were too stringent, while the Friends of Fish supported the approach of the Chair's text.[53]

In July 2008, the Chairman of the WTO Negotiating Group on Rules sent a fax to negotiating Members outlining his view as to how the Rules negotiations could proceed. On fisheries subsidies, he said candidly, in light of the fact that there were no pre-existing GATT/WTO agreements in this area and that the differences among delegations were on the very concepts and structure of the rules, that further discussion was necessary for a revision of the Chair's text, and that he would table a road map identifying the key questions to be addressed in order to reconcile

[51]The following eight categories of subsidies were prohibited: (1) subsidies on the acquisition and repair of fishing vessels, (2) subsidies on transfer of fishing vessels to third countries, (3) subsidies on operating costs of fishing vessels, (4) subsidies for port infrastructure exclusively or predominantly related to marine capture fishing, (5) income support for natural or legal persons engaged in marine capture fishing, (6) price support for products of marine capture fishing, (7) subsidies arising from the transfer of access rights, and (8) subsidies on any fishing vessel engaged in illegal, unreported or unregulated fishing (IUU fishing). See *ibid*., Article I.1.

[52]They were the following five categories of general exceptions: (1) subsidies for improving fishing vessel and crew safety, (2) subsidies exclusively for the adoption of gear for selective fishing techniques or other techniques aimed at reducing the environmental impact of marine capture fishing, (3) subsidies for re-education, retraining or redeployment of fish workers into occupations unrelated to marine capture fishing, (4) subsidies for vessel decommissioning or capacity reduction programs, and (5) user-specific allocations to individuals and groups under exclusive quota programs. See *ibid*., Article II.

[53]See Nakagawa (2010), pp. 48–49.

the approaches.[54] The Roadmap, submitted in December 2008, therefore, enumerated a number of issues to be discussed so as to reconcile the conflicting approaches with respect to, among others, subsidies that should be prohibited and exempted form disciplines, instead of presenting a revised text.[55] The ensuing negotiations on fisheries subsidies, however, has made little progress on such critical issues as prohibited subsidies and exceptions, special and differential treatment to developing countries, and fisheries management systems, and a revised text has not been submitted yet.[56]

4.2 Provisions of the TPP on Fisheries Subsidies

The US and Peru, members of the Friends of Fish, intended to materialize their negotiating position at the stalled Doha negotiation on fisheries subsidies in the provisions of the TPP on fisheries subsidies.[57] Japan, as a latecomer in the TPP negotiations and a proponent of the conflicting position at the Doha negotiation on fisheries subsidies, tried to mitigate the discipline on fisheries subsidies advocated by the US and Peru. Article 20.16 of the TPP was the result of the negotiation, reflecting the compromise reached between these two conflicting positions.[58] Article 20.16 has a structure that is different from that of the Chair's text, consisting of four components, namely, (1) fisheries management system, (2) prohibition of subsidies that contribute to overfishing and overcapacity, (3) notification requirements on fisheries subsidies, and (4) provisions for combating IUU fishing.

4.2.1 Fisheries Management System

The first paragraph of Article 20.16 acknowledge the importance of taking measures aimed at the conservation and the sustainable management of fisheries

[54]WTO News Release, Chair outlines future work in Rules negotiations, 14 July 2008. Available at https://www.wto.org/english/news_e/news08_e/rules_14july08_e.htm. Accessed 31 January 2016.

[55]WTO Negotiating Group on Rules, New Draft Consolidated Chair Texts of the AD and SCM Agreements, Annex VIII Fisheries Subsidies – Roadmap for Discussions, TN/RL/W/236, 19 December 2008, p. 85.

[56]See Cho (2015), pp. 11–12.

[57]For the US' negotiating position on fisheries subsidies, see Office of the United States Trade Representative, The Trans-Pacific Partnership: Detailed Summary of US Objectives, September 2015, p. 18 (It says, as one of the US negotiating objectives, to "(e)stablish rules to prohibit some of the most harmful fisheries subsidies, such as those that contribute to overfishing".) Available at https://ustr.gov/sites/default/files/TPP-Detailed-Summary-of-US-Objectives.pdf. Accessed 31 January 2016. Also see Fergusson et al. (2015), pp. 40–41.

[58]The legally verified text of the TPP was released on 26 January 2016 and is available at https://tpp.mfat.govt.nz/text. Accessed 31 January 2016.

(Article 20.16(1)). The second paragraph expresses the Parties' acknowledgement that inadequate fisheries management, fisheries subsidies that contribute to overfishing and overcapacity, and the IUU fishing can have significant negative impacts on trade, development and the environment (Article 20.16.2.). Based on these acknowledgements, the first legal obligation in Article 20.16 is on a fisheries management system. Article 20.16.3 obliges each Party to seek to operate a fisheries management system that is designed to (1) prevent overfishing and overcapacity, (2) reduce bycatch of non-target species and juveniles, and (3) promote the recovery of overfished stocks. Such a management system shall be based on the best scientific evidence available and on internationally recognized best practices for fisheries management and conservation as reflected in the relevant provisions of international instruments.[59] While the legal effect of this obligation is limited, as it is a "best effort" obligation ("(e)ach Party shall *seek to* operate . . ." (italics added by the author)), its effectiveness is strengthened through its connection with the internationally recognized best practices as reflected in the relevant provisions of international instruments.

4.2.2 Prohibition of Subsidies That Contribute to Overfishing and Overcapacity

Paragraph 5 of Article 20.16 provides for the prohibition of fisheries subsidies that contribute to overfishing and overcapacity. Its first sentence refers to the Parties' recognition that the implementation of a fisheries management system designed to prevent overfishing and overcapacity must include the control, reduction and eventual elimination of all subsidies that contribute to overfishing and overcapacity. It must be noted that elimination of subsidies that contribute to overfishing and overcapacity is not a legal obligation imposed on the Parties. Nor is it an immediate goal, as it is a long-term goal ("eventual elimination"). The same paragraph then sets out a general prohibition of fisheries subsidies, as follows.

> . . . (N)o Party shall grant or maintain any of the following subsidies . . .:
>
> (a) Subsidies for fishing that negatively affect fish stocks that are in an overfished condition; and
> (b) Subsidies provided to any fishing vessel while listed . . . for IUU fishing . . .

Paragraph 6 of Article 20.16 provides for a 3-year grace period for those subsidy programs that are inconsistent with paragraph 5(a).

Although seemingly a straightforward general prohibition of fisheries subsidies that contribute to overfishing and overcapacity, its legal effect is limited in practice,

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[59]Footnote 12 to Article 20 lists examples of such international agreements as follows: UN Convention on the Law of the Sea (UNCLOS), the UN Fish Stocks Agreement of 1995, the 1995 FAO Code of Conduct for Responsible Fisheries, the FAO Compliance Agreement of 1993, and the 2001 FAO IPOA-IUU Fishing. For the details of these international agreements, see Nakagawa (2010), pp. 31–37.

for the following reasons. First, so as to be categorized as prohibited subsidies under Article 20.16(5)(a), two cumulative conditions must be satisfied, namely, (1) the subsidies must negatively affect overfished fish stocks, and (2) the fish stocks must be in an overfished condition. Secondly, these two conditions must be determined based on the best scientific evidence available.[60] Accordingly, if a Party operates a fisheries management system that is designed to prevent overfishing and overcapacity and is based on the best scientific evidence available, as required under Article 20.16.3, the Party is not required to eliminate subsidies to the fish stocks that are targeted by the fisheries management system unless (1) the fish stocks are in an overfished condition, and (2) the subsidies negatively affect the fish stocks. In other words, a Party is allowed to provide fisheries subsidies on condition that it operates *an effective* fisheries management system that is (1) designed to prevent overfishing and overcapacity, (2) based on best scientific evidence available, and (3) based on internationally recognized best practices as reflected in the relevant international instruments. Even when the fisheries management system is not effective in the sense that the fish stocks in question are in an overfished condition, the Party is not required to eliminate the subsidies unless they negatively affect the fish stocks in question.[61] It is, therefore, not surprising that the Japan Fisheries Agency reportedly explained that it has no fisheries subsidy program that is categorized as prohibited under Article 20.16.5(a).

4.2.3 Notification Requirements on Fisheries Subsidies

Paragraphs 9–12 provide for the notification requirements of any fisheries subsidy program of each Party. Each Party shall notify the other Parties, within 1 year of the entry into force of the TPP and every 2 years thereafter, of any fisheries subsidy program that it grants or maintains (Article 20.16.9). Paragraph 10 specifies the content of the notification, including the status of the fish stocks for which the subsidy is provided (for example, overexploited, depleted, fully exploited, recovering or underexploited) (Article 20.16.10(d) and conservation and management measures in place for the relevant fish stock (Article 20.16.10(f)). Each Party shall also provide information in relation to other fisheries subsidies that it grants or maintains that are not covered by paragraph 5, in particular fuel subsidies (Article 20.16.11). It must be noted that the requirements under paragraphs 10 and 11 are best-effort requirements, while the requirement under paragraph 9 is not.

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[60]Footnotes 15 and 16 to Chapter 20 clarify these requirements. Footnote 15 provides that the negative effect of such subsidies shall be determined based on the best scientific evidence available. Footnote 16 provides that a fish stock is overfished if the stock is at such a low level that mortality from fishing needs to be restricted to allow the stock to rebuild to a level that produces maximum sustainable yield (MSY) based on the best scientific evidence available.

[61]See Nihon Keizai Shimbun electronic edition, 17 October 2015, available at http://www.nikkei.com/article/DGXLASFS16H5Y_W5A011C1PP8000/. Accessed 31 January 2016.

4.2.4 Provisions for Combating IUU Fishing

Finally, paragraphs 13–15 of Article 20.16 provide for cooperation among the Parties to combat IUU fishing. First, the Parties recognize the importance of concerted international action to address IUU fishing as reflected in regional and international instruments (Article 20.16.13).[62] In support of these international efforts to address IUU fishing, then, each Party shall (1) cooperate with other Parties to identify needs and to build capacity to support the implementation of this Article, (2) support monitoring, control, surveillance, compliance and enforcement systems of (i) deterring vessels that are flying its flag and its nationals from engaging in IUU fishing, and (ii) addressing the transshipment at sea of fish or fish products caught through IUU fishing, and (3) implement port State measures,[63] among others (Article 20.16.14).

4.3 Legal Implications of the Provisions of the TPP on Fisheries Subsidies

The provisions of the TPP on fisheries subsidies are unique in that they build on the general discipline on subsidies under the WTO law, as embodied in the Agreement on Subsidies and Countervailing Measures (SCM Agreement). The most notable WTO-plus discipline is the prohibition of fisheries subsidies that contribute to overfishing and overcapacity under Article 20.16.5(a), as it creates a new category of prohibited subsidies in addition to the two prohibited subsidies under the SCM Agreement, namely, export subsidies and subsidies contingent on the use of domestic over imported products (Article 3.1(a) and (b) of the SCM Agreement). This is unique because the basis of the prohibition is not on the trade effect of such subsidies, but on their environmental effect, namely their contribution to overfishing and overcapacity.

This was the result of the US and Peru's strategy of shifting a negotiating forum of disciplining fisheries subsidies from the stalled Doha negotiation on Rules to the TPP. At the same time, as a result of a compromise between the US and Peru and Japan, who persistently resisted against stringent discipline on fisheries subsidies during the Doha negotiation on Rules and the negotiation of the TPP, Article 20.16

[62] Footnote 20 of Chapter 20 lists examples of such regional and international instruments as follows: the 2001 IPOA-IUU Fishing, the 2005 Rome Declaration on IUU Fishing, the Agreement on Port State Measures to Prevent, Deter and Eliminate Illegal, Unreported and Unregulated Fishing, done at Rome, 22 November 2009.

[63] Port State measures to address IUU fishing are provided by the 2009 Agreement on Port State Measures to Prevent, Deter and Eliminate IUU fishing, as mentioned in footnote 20 of Chapter 20. The measures include inspection and follow-up actions. See Articles 12–19 of the Agreement. The text of the 2009 Agreement is available at http://www.fao.org/3/a-i1644t.pdf. Accessed 31 January 2016.

allows a Party to provide fisheries subsidies insofar as the Party operates an effective fisheries management system. As the effectiveness of the fisheries management system is determined based on the best scientific evidence available and on internationally recognized best practices for fisheries management as reflected in the relevant provisions of international instruments, the provisions of the TPP on fisheries subsidies incorporates existing international arrangements for fisheries management.

5 Concluding Remarks

This chapter analyzes provisions of several FTAs in the Asia Pacific region that deal with natural resources, namely, the chapters on energy and mineral resources of the NAFA and two Japanese EPAs with resource producing countries in the region, and the provisions of the TPP on fisheries subsidies. The chapters on energy and mineral resources of the NAFTA and two Japanese EPAs share a common goal of securing stable supply of natural resources between the Parties, but the measures they adopt are slightly different in their legal characteristics. The NAFTA chapter on energy and basic petrochemicals aims at securing stable supply of these resources by constraining the Party's right to restrict exports of these resources through WTO-plus requirements on export restrictions and export taxes.[64] Chapters on energy and mineral resources of two Japanese EPAs with Indonesia and Australia also aim at securing stable supply of these resources, but they have fewer WTO-plus requirements than the NAFTA and they are mainly transparency requirements for export restrictions and energy and mineral resource regulatory measures. Rather than constraining the Party's right to restrict export of energy and mineral resources, they mainly aim at establishing a channel for consultation between the Parties for the stable supply of these resources.

The provisions of the TPP on fisheries subsidies are different from the chapters on energy and mineral resources of the NAFTA and two Japanese EPA in the goals that they aim at, as well as in the measures that they adopt. The provisions of the TPP on fisheries subsidies aim at securing conservation and sustainability of fisheries resources, rather than their stable supply between the Parties. So as to achieve this goal, they prohibit fisheries subsidies that contribute to overfishing and overcapacity. Adoption of these rules in the TPP was accidental in the sense that the US and Peru intended to shift the forum for disciplining fisheries subsidies from the

[64]It must be noted, however, that the NAFTA chapter on energy and basic petrochemicals is practically a bilateral agreement between Canada and the US, as Mexico was exempted from most of the obligations under the chapter.

stalled Doha negotiations on Rules to the TPP. Accordingly, the provisions of the TPP on fisheries subsidies should be regarded as an example of standard-setting through FTAs for the purpose of eventual rule making at the multilateral level.[65]

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[65] On standard-setting through FTAs, see Nakagawa (2009), pp. 79–83.

Chapter 9
Comment to Chapter "Free Trade Agreements and Natural Resources"

Y. Fukunaga

Abstract As Professor Nakagawa's chapter rightly points out, natural resources have "unique economic characteristics" that require a special treatment under international trade law. In particular, their exhaustible nature justifies the adoption of restrictions on their exports that are otherwise inconsistent with international trade law, for the purpose of conservation. For example, an exporting country may claim that it is justified in adopting quantitative restrictions on the exports of natural gas in order to preserve gas reserves in its territory. Or, it may try to justify the imposition of export duties on a certain raw material in order to ensure that the material is sufficiently supplied to the domestic user industry.

Keywords Japan – Indonesia EPA • Japan's Strategic Energy Plan • Indonesia's export restrictions

1 Introduction

As Professor Nakagawa's chapter rightly points out, natural resources have "unique economic characteristics" that require a special treatment under international trade law.[1] In particular, their exhaustible nature justifies the adoption of restrictions on their exports that are otherwise inconsistent with international trade law, for the purpose of conservation. For example, an exporting country may claim that it is justified in adopting quantitative restrictions on the exports of natural gas in order to preserve gas reserves in its territory. Or, it may try to justify the imposition of export duties on a certain raw material in order to ensure that the material is sufficiently supplied to the domestic user industry.

Export restrictions, such as export quantitative restrictions and export duties, are subject to WTO rules, including the most-favoured-nation principle under Article I:1 of General Agreement on Tariffs and Trade (GATT) and the general elimination

[1] Nakagawa (2016).

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_9

of quantitative restrictions under Article XI:1 of GATT, along with exception clauses such as Articles XI:2 and XX of GATT. Nevertheless, it is sometimes argued that the World Trade Organization (WTO) rules do not sufficiently regulate export restrictions because their focus is on import restrictions.[2] It is this alleged limitation of the WTO rules that drives some countries, including Japan, to adopt Free Trade Agreements (FTAs) that include an independent chapter on natural resources. As a resource-scarce country, Japan sees FTAs as a tool to secure a stable supply of energy and mineral resources.[3]

Professor Nakagawa's chapter analyzes rules on natural resources provided for in the North American Free Trade Agreement (NAFTA) as well as those provided for in Japan's Economic Partnership Agreements (EPAs) with Indonesia and Australia,[4] and concludes that, while NAFTA and Japan's EPAs share the "common goal of securing [a] stable supply of natural resources between the parties," their specific rules on natural resources are different. On one hand, NAFTA prohibits certain WTO-consistent export restrictions such as minimum or maximum export price requirements and export duties, and limits the application of the exceptions under the WTO by adding procedural and substantive conditions.[5] On the other hand, Japan's EPAs mostly limit themselves to improving the transparency of export restrictions and enhancing cooperation, and stop short of adding WTO-plus rules.[6]

Against this background, this paper analyzes whether and how Japan's EPAs can contribute to securing a stable supply of natural resources. In particular, it focuses on trade in natural resources between Japan and Indonesia and the potential impacts of the Japan – Indonesia EPA. It focuses on Indonesia because Indonesia has adopted export restrictions that concern Japan and other resource importing countries. It discusses whether the restrictions adopted by Indonesia are consistent with the WTO, and whether and how the EPA could fill the alleged gap in the WTO rules.

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[2]Id., p.[TBA]. Espa points out that, while various WTO rules apply to both import and export restrictions, tariff concessions made by WTO Members are almost exclusively limited to import tariffs. Espa (2015), pp. 165–166.

[3]METI (2015), p. 773.

[4]His paper also examines provisions of the Transpacific Partnership Agreement (TPP Agreement) on fisheries subsidies. However, this comment will not discuss them because, unlike NAFTA and Japan's EPAs with Indonesia and Australia, the TPP provisions on fisheries subsidies aim at preserving fisheries resources rather than securing a stable supply. Nakagawa (2016), p. [TBA].

[5]Nakagawa (2016), p. [TBA].

[6]Id., p. [TBA].

2 Trade in Natural Resources and Japan

2.1 Japan's Dependence on Imports and Basic Policy on Natural Resources

Japan is a resource-scarce country and is heavily dependent on imports of energy and natural resources. According to the statistics in 2013, Japan's energy self-sufficiency rate is only 6 %.[7] Its oil self-sufficiency is 0.3 %,[8] and the LNG self-sufficiency is 2.4 %.[9] Japan also relies on imports for most of its mineral resources, including common and rare metals. Thus, it is critical for Japan to secure a stable supply of energy and mineral resources from overseas.

In April 2014, the Japanese government published the "Strategic Energy Plan" pursuant to the Basic Act of Energy Policy. The Act was enacted in June 2002 in order to ensure the steady implementation of energy policy,[10] and requires a strategic energy plan to be adopted and then reviewed at least once every 3 years.[11] The Plan of 2014 insists on the importance of strengthening external relations in securing a stable supply of energy and mineral resources in light of Japan's "fundamental vulnerability", which is exacerbated by the growing energy demand of emerging countries and the shut-down of nuclear power plants after the Fukushima nuclear power plants accident.[12]

One of the Plan's core strategies is to promote the investment in the mining industries of resource-supplying countries and raise the ratio of self-development.[13] More specifically, its goal is to raise the ratio of self-development for oil and natural gas to 40 % or higher by 2030.[14] It is expected that the emergence of new resource-supplying countries will increase opportunities for Japanese investors to participate in upstream development projects of oil, gas, coal, and metal mines.[15] In order to encourage upstream investments, the Plan states that Japan will "invigorate diverse economic transactions and human exchanges at various levels of society"[16] through enhanced international dialogue such as the LNG Producer – Consumer

[7] ANRE (2015), p. 110.

[8] Id., p. 121.

[9] Id., p. 124.

[10] Strategic Energy Plan (2014), p. 4.

[11] Id.

[12] Id., pp. 7–9.

[13] The ratio of self-development is defined as the amount of the import volume of energy and natural resources that are developed under the control of Japanese enterprises plus domestic production volume divided by the total amount of import volume of energy and natural resources plus domestic production volume. METI/ANRE Press Release (August 24, 2015).

[14] Sectional Committee Report, p. 18. The ratio hit the record high of 24.72 % in 2014. METI/ANRE Press Release (August 24, 2015).

[15] Strategic Energy Plan (2014), p. 32.

[16] Id.

Conference, Japan – India Energy Dialogue and Japan – South Korea Gas Dialogue.[17] In addition, Japan's technical assistance in mining sectors is expected to stabilize the supply of resources from developing countries.[18]

It is notable that the Plan mentions little about the role of trade regulations. Trade regulations under EPAs are considered, at most, to reinforce economic relationships with resource-supplying countries.

2.2 Specific Concerns Regarding Trade with Indonesia

Indonesia is one of the major exporters of natural resource to Japan. For example, Indonesia is the second largest exporter of coal to Japan, second only to Australia: 13.8 % of steam coal imports and 27.1 % of coking coal imports.[19] While Japan imports oil mostly from the Middle East, 3.2 % of oil imports comes from Indonesia.[20] Indonesia also ranks fourth in imports of liquefied natural gas (LNG), accounting for 7.5 % of Japan's total imports.[21]

Indonesia is particularly important for Japan as a source of mineral resources. However, its adoption of export restrictions in 2014 has disrupted the supply of mineral resources to Japan. For example, Indonesia had been the largest exporter of nickel ore to Japan until 2013, when its import share peaked at 50.2 %.[22] However, as a result of the restrictions, its exports stopped in 2014, and the nickel price soared, hurting Japanese producers of ferronickel.[23] Indonesia was also a major exporter of bauxite, but its exports stopped as well after the adoption of the measures. Indonesia is still the largest exporter of block tin, accounting for 40 % of Japanese imports, but the import volume in 2014 was the lowest in the last 10 years.[24]

The export restrictions were adopted pursuant to Indonesia's revised Law No. 4 of 2009 on Coal and Mineral Mining [Revised Mining Act], which came into effect in January 2009. The objective of the Revised Mining Act is to raise the value-added of mineral resources exported from Indonesia. To this end, Indonesia adopted a regulation in 2014 that prohibits the exports of certain metals, such as nickel and bauxite, unless they are refined in the country. Other kinds of metals, such as copper ore and iron ore, are exempt from the prohibition until the beginning of 2017, but are subject to export duties.[25]

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[17]Id., p. 33. *See also* Id., pp. 79–82.

[18]Mining Committee Interim Report, p. 36.

[19]ANRE (2015), pp. 128–129.

[20]Id., p. 121.

[21]Id., p. 125.

[22]JOGMEC (2015), Nickel, p. 8.

[23]Interim Report, p. 39.

[24]JOGMEC (2015), Tin, p. 6.

[25]The description of the measures is based on JOGMEC (2016). The measures may be subject to change.

The Revised Mining Act and its relevant measures have stopped the exports of essential metal resources such as nickel to Japan as pointed out above. Moreover, in 2014, Indonesia adopted the Industry Law and the Trade Law, which empower the Indonesian government to impose export bans on raw materials. These laws have added even more uncertainty to the exports of mineral resources from Indonesia.[26] Japan has been raising concerns in WTO meetings as well as meetings under the auspices of the Japan – Indonesia EPA.[27] Other WTO Members, such as the U.S. and the E.U., have echoed these concerns.[28] The U.S. and the E.U. have also raised concerns regarding the local content requirement in the Indonesian mining industry.[29]

3 Evaluation Under the WTO Agreement and the Japan-Indonesia EPA

3.1 Consistency with the WTO Agreement

Although the consistency with the WTO Agreement of export restrictions is discussed elsewhere in this book,[30] it is worth briefly mentioning the consistency of Indonesia's export restrictions.

First, Indonesia's export restrictions may not be consistent with some rules of the WTO Agreement. For example, the prohibition of certain metal resources exports imposed by Indonesia is likely to be found inconsistent with Article XI:1 of GATT and Article 2 of TRIMs Agreement. In addition, the local content requirement appears inconsistent with Article III:4 of GATT and Article 2 of TRIMs Agreement. While export duties are not prohibited by the WTO Agreement, those imposed by Indonesia could be found to violate Article I:1 or Article X:3(a) of GATT if they were applied in a discriminatory or unfair manner.

Second, exception clauses under the WTO Agreement could be invoked, but Indonesia's measures may not satisfy the requirements for justification. For example, Indonesia may claim that its export prohibition is justified under Article XI:2 (a) as a measure to "prevent or relieve critical shortages of" mineral resources that are essential to Indonesia. However, given the abundant potential reserves of mineral resources, such as nickel, in the territory and the limited use of these resources by the Indonesian industries, it is doubtful that the measure is justified by the provision. Alternatively, Indonesia may rely on Article XX(g), claiming that its export restrictions constitute measures "relating to the conservation of

[26] METI (2015), p. 80.

[27] Id.

[28] *See*, e.g., CTRIMs Minutes July 2015, paras. 57–91.

[29] Id., paras. 58–59.

[30] Chapter [TBA].

exhaustible natural resources." However, it has to be pointed out that Indonesia's measures are not an outright prohibition of exports; they simply impose conditions on exports. More specifically, Indonesian law states that mineral resources can be exported if they meet a minimum value-added threshold. This suggests that the objective of the Indonesia's measures may be to develop its mining industry rather than to preserve its mineral resources. Put differently, it seems questionable that a "close and genuine relationship of ends and means" exists between the measures and the conservation of mineral resources.

3.2 Japan-Indonesia EPA

The brief analysis above suggests that Indonesia's export restrictions are likely in violation of its obligations under GATT and un justified by the exception clauses. As pointed out in Professor Nakagawa's Chapter, Article 99.1 of the Japan – Indonesia EPA confirms that the relevant obligations under GATT apply to "prohibitions or restrictions on the importation or exportation of energy and mineral resource goods." The export duties that are not prohibited by the WTO Agreement are not covered by the Japan – Indonesia EPA. As far as the scope of prohibition is concerned, the EPA adds little to the GATT rules.

It might be argued that the EPA should have provided WTO-plus rules as does NAFTA. However, given the extremely uneven distribution of natural resources between Japan and Indonesia, such WTO-plus rules could end up imposing unilateral obligations on the latter country.

Moreover, the significance of the procedural requirements added by the Japan – Indonesia EPA should not be discounted. For example, under Article 99.2 of the EPA, Indonesia is required to "provide relevant information" concerning export restrictions of an energy and mineral resource good as early as possible and "reply . . . to specific questions on" such restrictions "with a view to avoiding disruption of ordinary business activities in the Parties." In addition, under Article 101, in the application of any energy and mineral resource regulatory measures, the Indonesian authority shall "avoid disruption of contractual relationships . . . to the maximum extent practicable," implement the measures "in an orderly and equitable manner," "notify" Japan of the measures, and "respond . . . to specific questions." While these requirements do not necessarily prevent Indonesia from adopting export restrictions on energy and mineral resources, they are expected to ensure that any restrictions are adopted and implemented in a transparent and reasonable manner. In fact, it is often the unpredictability of relevant law and policy that disrupts trade in natural resources between Japan and Indonesia.

Finally, it is useful to highlight different impacts of trade rules on import barriers and on export barriers. On one hand, import barriers prevent producers from selling their products in overseas markets, and the removal of these barriers through trade

rules gives them opportunities to sell their products in overseas markets. While the opportunities cannot be seized unless consumers/industrial users overseas are willing to buy the products, the producers can at least pick and choose markets with higher demands. They can also influence consumer choices by, for example, introducing a better product or engaging in effective public relations.

On the other hand, export barriers prevent consumers/industrial users from buying products of foreign producers, and the removal of these barriers gives them opportunities to buy the products. The problem is, unlike producers, consumers/industrial users have little power to choose trading partners or to influence producers’ choices. Take, for example, a rare metal that is unevenly distributed in a single country and exploited by a single producer. Even without export restrictions, if the producer is unwilling to sell the metal, consumers/industrial users overseas may not be able to obtain it or they may be forced to pay high prices to buy the metal. In short, the removal of export barriers does not create trade flows if producers are not willing to sell their products to foreign consumers/industrial users.

From the example above, it is implied that it is essential for resource-importing countries to be engaged not only in trade but also in production in resource-exporting countries in order to secure a stable supply of natural resources. This is why Japan has been insisting on raising their ratio of self-development.[31] From a legal perspective, Japan needs to adopt international rules that regulate both export restrictions and production restrictions. To this end, Article 98 of the Japan – Indonesia EPA specifically provides for cooperation in promoting and facilitating investments between the Parties in the energy and mineral resource sector in addition to the general rules of investment under Chap. 5. Given the fact that export restrictions on natural resources are often accompanied by production restrictions, investment rules under the EPA are expected to play a key role in securing a stable supply of natural resources.[32]

4 Conclusion

This comment analyzes trade in natural resources between Japan and Indonesia and the potential impacts of the Japan – Indonesia EPA. It concludes that trade rules under the EPA contribute to securing a more predictable and transparent trade environment, although it may not necessarily secure a stable supply of energy and mineral resources from Indonesia. It also points out that trade rules need to be accompanied by investment rules in order to ensure that Japanese enterprises effectively engage not only in trade but also in upstream development projects.

[31] *See* Sect. 2.1. of this comment.

[32] The relevance of investment rules is discussed in Chapter [TBA] in the book.

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Part IV
Competition Law Issues Relating to Exportation of Natural Resources

Chapter 10
The Iron Ore Production Joint Venture Between Rio Tinto and BHP Billiton: The European Angle of a Multinational Antitrust Review

Jean-François Bellis

Abstract In 2009–2010, the European Commission and the German Federal Cartel Office (FCO) reviewed the proposed iron ore production joint venture in Western Australia between BHP Billiton ("BHPB") and Rio Tinto ("Rio"). This transaction was announced in June 2009 but was finally abandoned by the parties in October 2010 due to antitrust concerns.

While no formal decision on the proposed BHPB/Rio joint venture has been issued, neither by the European Commission nor the German FCO, this case is nonetheless noteworthy in that It is very rare for European competition authorities to oppose pure production joint ventures, let alone one in which the production takes place entirely outside of the EU and only relatively small amounts of the jointly produced products would likely be sold in the EU.

Keywords Competition law and natural resources • Joint ventures

The present article discusses the European Commission's review of the proposed iron ore production joint venture in Western Australia between BHP Billiton ("BHPB") and Rio Tinto ("Rio"), which was announced in June 2009, and was finally abandoned by the parties in October 2010 due to antitrust concerns. It also

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Managing Partner, Van Bael & Bellis, Brussels. Professor, Institute of European Studies, University of Brussels (ULB) I wish to express my appreciation to my colleagues Stephanie Reinart and Johan Van Acker at Van Bael & Bellis for their contribution in drafting this article. Van Bael & Bellis represented the five leading Japanese steel mills which intervened in the proceedings in Europe in opposition to the joint venture. This article is based on a paper presented at the International Bar Association Conference in Florence on 16–17 September 2011 in which this transaction was the subject of a case study by a number of practitioners involved in the proceedings in Europe and Asia

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© Springer Japan 2016
M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_10

reviews the parallel assessment of the proposed joint venture by the German Federal Cartel Office (FCO), as a notified concentration under the German merger rules. From a European competition law viewpoint, this case presents indeed the interesting feature that the transaction was assessed by the Commission as an agreement falling under Article 101 TFEU while it was analyzed as a concentration by the FCO, thus leading to a very rare situation of concurrent jurisdiction by the European Commission and a Member State competition authority.

Rio and BHPB are two leading global mining groups active in, among other things, iron ore, which is a key raw material for the production of steel. On the worldwide market for seaborne iron ore (i.e. iron ore transported by sea), Rio and BHPB are, respectively, the second and third largest suppliers, after the market leader Vale (Brazil). The three major iron ore producers, Vale, Rio and BHPB, together account for around three quarters of the global seaborne iron ore market and are often referred to in the industry as the "Big Three" producers. There are indeed indications that BHPB, Rio and Vale together account for almost 90 % of the contract seaborne market for fines and for 76 % of the contract seaborne market for lump.[1]

Of the "Big Three", Rio and BHPB are each other's closest competitors, as they both have their main iron ore deposits in Western Australia, whereas Vale's mines are located mainly in Brazil. Faced with such a concentrated supply of seaborne iron ore, many steel producers across the globe – including the Japanese steel mills – are highly dependent on one or more of these "Big Three" suppliers for their iron ore requirements which are necessary to keep their steel mills running.

Interestingly, the story of attempted combinations between BHPB and Rio does not start with the 2009 iron ore production joint venture. This joint venture was already the second attempt to combine the two groups. At the end of 2007, BHPB had planned to acquire Rio by way of a hostile takeover bid. This concentration was notified to the European Commission in May 2008 under the EU Merger Regulation.[2] In light of concerns expressed about this takeover by steel mills across the globe, the Commission opened an in-depth second phase investigation of the notified concentration in July 2008. On 3 November 2008, the Commission issued a scathing statement of objections, indicating that the concentration would eliminate competition between Rio and BHPB in seaborne iron ore (in particular, lump and fines). The Commission also raised competition concerns with regard to metallurgical coal, uranium and aluminum. On 25 November 2008, i.e. only a few weeks after the issuance of the statement of objections and without having

[1]The main iron ore products used for steel production are lumps, fines and pellets. Lumps and fines are produced from the same type of iron ore concentrate and are separated by screening and sorting, with the diameter of lumps particles generally measuring more than 4.75 mm and the diameter of fines particles generally measuring less than 4.75 mm. Fines are more difficult to process because they must be sintered by the steel mill before they can be charged to the blast furnace.

[2]Case No COMP/M.4985 – BHP Billiton/Rio Tinto.

responded to the preliminary findings set out therein, BHPB formally abandoned its takeover bid and withdrew its merger notification.

On 5 June 2009, i.e. only 6 months after BHPB had abandoned its hostile takeover bid for Rio, BHPB and Rio entered into a preliminary agreement to establish a 50/50 production joint venture combining their iron ore assets in Western Australia.[3] This joint venture would combine Rio's and BHPB's main iron ore mines and infrastructure, which are located in the Pilbara region in Western Australia. In short, according to this agreement, the parties would jointly produce iron ore through the joint venture, share the resulting output on a 50–50 basis, standardize their iron ore products and coordinate future capacity expansions.

The initial joint venture agreement also foresaw some joint selling, as 10–15 % of the jointly produced ore was to be sold by the joint venture itself. However, in October 2009, BHPB and Rio abandoned the joint marketing/selling aspect of the joint venture and announced that they would sell the joint venture's entire output through their independent marketing arms.[4] On 5 December 2009, BHPB and Rio announced that they had signed binding agreements on the establishment of the proposed production joint venture, without joint marketing activities.[5]

More precisely, under the revised joint venture agreement, BHPB and Rio planned to operate their Western Australian iron ore production assets as follows (for more details, see the Term Sheet published by BHPB and Rio on 5 June 2009)[6]:

- jointly operate their mines, railways and port facilities in Western Australia, from where iron ore is shipped to customers in Asia, Europe and elsewhere;
- jointly explore new iron ore deposits;
- jointly expand their infrastructure (mines, railways, port facilities);
- standardize their respective iron ore products into a few product blends;
- split the costs of production and share the output on a 50/50 basis;
- sell the output through each of BHPB's and Rio's respective marketing arms.

Several competition authorities around the world reviewed the joint venture under their competition rules, such as the European Commission (under Article 101 of the Treaty on the Functioning of the European Union ("TFEU")), the FCO (as a concentration under the German merger control rules), the Australian

[3]The press release of 5 June 2009, including the "core principles" of the joint venture attached thereto (hereinafter referred to as the "Term Sheet") can be found under the following link: http://www.riotintoironore.com/documents/090605_Rio_Tinto_and_BHP_Billiton_announce_West_Australian_Iron_Ore_Production_Joint_Venture.pdf.

[4]See press release of 15 October 2009 which can be found under the following link: http://www.riotinto.com/documents/PR768g_Rio_Tinto_and_BHP_Billiton_update_on_proposed_iron_ore_production_joint_venture.pdf.

[5]See press release of 5 December 2009 which can be found under the following link: http://www.riotinto.com/documents/PR780g_Rio_Tinto_and_BHP_Billiton_sign_binding_agreements.pdf.

[6]The press release of 5 June 2009, including the "Term Sheet" attached thereto can be found under the following link: http://www.riotintoironore.com/documents/090605_Rio_Tinto_and_BHP_Billiton_announce_West_Austr alian_Iron_Ore_Production_Joint_Venture.pdf

Competition and Consumer Commission, the Japanese FTC, the Korean FTC, the Chinese MOFCOM and the US Department of Justice.

This paper focuses on the European Commission's review of the proposed joint venture and the concerns expressed during this review by the five leading Japanese steel mills, which are among the largest iron ore customers of BHPB and Rio. Section A.1 discusses the issue of jurisdiction, section A.2 discusses the substantive concerns expressed by the Japanese steel mills under Article 101(1) TFEU and section A.3 discusses why claimed efficiencies were not sufficient to justify an exemption under Article 101(3) TFEU. Section B. addresses the parallel assessment of the proposed joint venture by the German Federal Cartel Office, as a notified concentration under the German merger control rules. By means of conclusion, section C. discusses the final outcome of the case and what sets this case apart from other Commission investigations under Article 101 TFEU.

1 Review of the Proposed Joint Venture by the European Commission

1.1 Jurisdiction of the European Commission to Review the Joint Venture Under Article 101 TFEU

As the production joint venture did not encompass any joint selling (after the parties had abandoned the initially envisaged joint marketing activities), the European Commission found that the joint venture would be entirely dependent on its parent companies for marketing iron ore and would thus not perform by itself the same functions as other companies operating in the iron ore markets. As such, the joint venture was considered to be a pure production joint venture, rather than a "full-function" joint venture, and thus did not constitute a "concentration" to be reviewed under the EU Merger Regulation.

However, the Commission assumed jurisdiction to review the proposed joint venture under Article 101 TFEU which, simply put, prohibits agreements that are restrictive of competition and are capable of affecting trade between EU Member States. Even though BHPB and Rio sold iron ore primarily to Asian steel mills, and had relatively limited sales to customers in the EU, the Commission seems to have taken the view that the joint venture was capable of affecting trade between EU Member States. Factors that are likely to have played in the Commission's decision are, inter alia, (i) the worldwide geographic scope of the seaborne iron ore markets; (ii) the fact that BHPB and Rio had some sales in the EU; and (iii) the fact that any restriction of competition between BHPB and Rio, and resulting price increase, would have had a knock-on effect on prices charged by Vale (the other "Big Three" supplier), which is the main iron ore supplier to European steel mills.

On 25 January 2010, the Commission opened a formal antitrust investigation to assess whether the joint venture restricted competition in the EU within the

meaning of Article 101(1) TFEU and, if so, whether the conditions for exemption under Article 101(3) TFEU were met.[7]

1.2 Substantive Concerns Expressed by the Japanese Steel Mills Under Article 101(1) TFEU

Iron ore customers across the globe, including the leading Japanese steelmakers, expressed grave concerns to the European Commission that the proposed joint venture would infringe Article 101(1) TFEU. The main competition law concerns about the proposed joint venture raised by iron ore customers, and the Japanese steelmakers in particular, can be summarized as follows:

- The joint venture would eliminate competition between BHPB and Rio in terms of *output*, as it would give BHPB and Rio the ability and incentive to coordinate and restrict production volumes. In accordance with the Term Sheet, BHPB and Rio would instruct the joint venture on what iron ore volumes are to be produced. These tonnage nominations would necessarily need to be coordinated between the parties as the resulting output would be allocated on a 50–50 basis. The proposed joint venture would thus create a mechanism for BHPB and Rio to discuss global seaborne iron ore demand and, on this basis, coordinate their production volumes in light of demand. BHPB and Rio would have the ability and incentive to restrict output through the joint venture. (For more details, see Sect. 1.2.1 below.)
- The joint venture would significantly restrict competition between BHPB and Rio in terms of *capacity expansions*, as it would give BHPB and Rio the ability and incentive to delay or cancel planned capacity expansions. The proposed joint venture would likely not only enable, but even require BHPB and Rio to consult and agree on expansion projects. Through the joint venture, BHPB and Rio would thus coordinate capacity expansions. The joint venture would give BHPB and Rio the incentive to delay or cancel capacity expansions, thus driving up iron ore prices.
- The joint venture would eliminate competition between BHPB and Rio in terms of *product quality*, as the parties announced that they would "standardize products as soon as practical".[8] The standardisation of products was expected to result in BHPB and Rio marketing exactly the same iron ore brands as one another, which would eliminate any possible differentiation in product quality between the parties. Moreover, this product standardization was expected to result in BHPB and Rio offering a more limited range of products of generally

[7] Case No COMP/39749 – Rio Tinto & BHP Billiton.

[8] Section 5.1 of the Term Sheet.

lower quality than would be the case in the absence of the proposed joint venture.

- The joint venture would reduce *price* competition between BHPB and Rio. Specifically, the joint venture would result in considerable commonality of costs between BHPB and Rio, thus significantly increasing the risk of price coordination between the parties. In addition, the potential scope for steel mills to play BHPB and Rio off one another during iron ore price negotiations would be further reduced, as the proposed joint venture would likely increase the similarity of BHPB and Rio in terms of long-term mining/pricing strategies, capital and operating costs, their views on the state of the market, and future long-term partnerships.
- The joint venture would inevitably result in an extensive exchange of sensitive information between BHPB and Rio, thus further facilitating coordination between the parties.
- The joint venture would facilitate coordination between BHPB, Rio and Vale.

1.2.1 Elimination of Competition Between BHPB and Rio in Terms of Output

BHPB and Rio compete head-to-head in terms of output (production volumes) of iron ore. This is true in oversupplied, balanced and undersupplied market conditions alike.

In balanced or oversupplied market conditions, iron ore suppliers compete on volumes by trying to settle the so-called iron ore "benchmark price" negotiations first in exchange for new or additional tonnages contracted with customers.[9] Essentially, iron ore suppliers will offer lower prices to customers in exchange for an agreement by the customer to buy larger volumes.

In undersupplied market conditions, competition on volumes may be less obvious as customers may have greater difficulty switching volumes from one supplier to another. However, an undersupplied market triggers capacity expansion projects that will help balance the market, assuming expansion decisions are taken independently, and short term pricing decisions will be linked to long term commitments for the expansion volumes. This creates competition on volumes between iron ore suppliers, even in tight market conditions.

The joint venture would eliminate this competition on output, as it would give BHPB and Rio the ability and incentive to coordinate and restrict production volumes. Indeed, the joint venture would provide the parties with a mechanism to coordinate their output, as well as the incentive to restrict output and thus drive up seaborne iron ore prices, as follows:

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[9]Benchmark price negotiations are a mechanism for price negotiations that has traditionally been used in the iron ore sector to determine annual reference prices (although the system has come under serious pressure recently).

- Based on the Term Sheet, BHPB and Rio would instruct the joint venture on what volumes are to be produced. BHPB and Rio would have the discretion to determine the proposed joint venture's output. The joint venture would then supply these volumes to the parties, in principle on a 50–50 basis. In order for this to work, BHPB and Rio would need to discuss global seaborne iron ore demand, their respective demand and, on this basis, would need to coordinate the volumes to be produced. This is because such an output allocation on a 50–50 basis could not work without the parties discussing and agreeing beforehand what volumes this 50 % would represent. Simply put, it cannot be the case that BHPB and Rio would separately nominate volumes without any coordination between them, as if this were the case, the resulting output, once split on a 50–50 basis, could result in either or both parties receiving greater or lesser volumes than what they require.
- The Term Sheet clearly states that BHPB and Rio would have to jointly approve the joint venture's business plans and budgets.[10] Even if there were no direct coordination at the time tonnages are nominated, coordination could occur in this context. Indeed, as output of a joint venture is typically a key factor in such business plans and budgets, it is likely that BHPB and Rio would be able to coordinate and agree on production volumes of the proposed joint venture when adopting and approving the business plans and budgets.

BHPB and Rio would not only have the ability but also the incentive to restrict output. A reduction in output would tighten the balance of supply and demand and would likely lead to iron ore price increases. This would be a profitable strategy for BHPB and Rio as long as the margin loss on withheld iron ore volume is offset by the margin gain on their sales.

The 50–50 output sharing rule is an additional feature of the joint venture that would serve to enhance the incentive of BHPB or Rio to withhold output. This is because the sharing rule creates a requirement that each party matches the withholding conduct of the other party. To engineer a given price increase, BHBP or Rio need only withhold half the amount of iron ore that would be needed without the proposed joint venture. The implication of this rule is that a price increase can be engineered at a lower cost to each party in terms of foregone profits, and this enhances their incentives to withhold.[11] The sharing rule thus means that, even if

[10]Sections 2.4(d)a and 2.4(d)d of the Term Sheet.

[11]This can be made concrete with a stylised example. Consider a hypothetical scenario where, absent the joint venture, Rio unilaterally decides to withhold 10 million tons per year of output and, as a consequence, loses a margin of US$ 300 million on the withheld sales. The benefit to Rio would be an increase in the margin on the remaining sales of, say, US$ 200 million (due to a higher market price following the withdrawal of the 10 million tons per year). In this hypothetical example, the withholding of 10 million tons per year would be unprofitable, and Rio therefore would not be expected to pursue such a withholding strategy. Now consider Rio's attitude to the same strategy within the joint venture. In order to achieve the same impact on market prices, the joint venture would need to reduce output by the same amount (10 million tons per year). The difference would be that a 10 million tons per year reduction in output by the proposed joint

the joint venture did not provide the parties with the ability to jointly determine how much output should be produced between them, it would nevertheless enhance their unilateral incentives to withhold output by reducing the cost of doing so.

In addition, there was a concern that competing iron ore suppliers, including both Vale and smaller producers, would be unable (e.g. for cost reasons) or unwilling (e.g. because they benefit from the higher prices) to increase output on a sufficient scale to make an output withholding strategy by BHPB and Rio unprofitable.

1.2.2 Significant Restriction of Competition Between BHPB and Rio in Terms of Capacity Expansions

BHPB and Rio compete head-to-head in terms of capacity expansions, both as regards mine expansions and infrastructure (rail and port) expansions. As such, BHPB and Rio constrain each other's decisions in terms of capacity expansions because each player knows that the other can defeat a reduction or delay of capacity expansions by filling the gap with virtually the same capacity expansion yielding the same product. Competition between BHPB and Rio with respect to capacity expansions is critical insofar as it leads to greater future output of iron ore. The Japanese mills were concerned that joint venture would significantly restrict competition between BHPB and Rio on capacity expansions, as it would give BHPB and Rio the ability and incentive to coordinate and delay or cancel planned capacity expansions.

While delays, suspensions and cancellations of expansions take place on an individual basis, the proposed joint venture would provide a mechanism for BHPB and Rio to coordinate their capacity expansion plans, and the parties would also have the incentive to limit planned expansions, as competing iron ore suppliers would be unwilling or unable to react on a sufficient scale to make such a reduction or delay of capacity expansions unprofitable for BHPB and Rio.

The joint venture calls for joint decision-making between BHPB and Rio on capacity expansions. Although the Term Sheet is sketchy on precisely how this joint decision- making would work in practice, it appears that any feasibility study on greenfield or brownfield expansions[12] would require consultation between BHPB and Rio. If the feasibility study is approved by the Owners' Council

venture would effectively be achieved by a 5 million tons per year reduction in sales by Rio and a 5 million tons per year reduction in sales by BHPB. The cost of the withholding to Rio would also be halved – falling from US$ 300 million to US$ 150 million. The benefits of the withholding would be undiluted – remaining at US$ 200 million. Rio would now have an incentive to pursue a previously unprofitable withholding strategy. (The same logic would apply to an assessment of BHPB's incentives to withhold supply with and without the joint venture.)

[12]The term "greenfield expansion" refers to expansions through the exploitation of new, previously unused sites. The term "brownfield expansion" refers to expansions of existing mines or the opening of new pits adjacent to existing mines.

(which consists of BHPB and Rio representatives), the expansion would be funded equally and capacity would be shared equally between BHPB and Rio.[13] If only one party wishes to proceed with an expansion, it appears that a distinction would need to be made between projects with a capital cost of more than US$ 250 million and projects whose capital cost does not exceed US$ 250 million:

- For projects under US$ 250 million, it appears from Section 6.7 of the Term Sheet that neither party would be allowed to sole risk an expansion: “To sole risk an expansion, the capital expenditure for the project must be greater than US$ 250 million (indexed)”. In other words, such smaller expansions – and potentially incremental expansions that are part of larger projects – would not be possible without the approval of both BHPB and Rio, and even then, these expansions could only be done jointly.
- For projects over US$ 250 million, Section 6.7 of the Term Sheet suggests that BHPB or Rio could in principle decide to proceed with the expansion on a sole risk basis. However, pursuant to Section 2.4(d)e of the Term Sheet, the Owners’ Council must “approve capital projects exceeding US$ 250 million”. This suggests that expansion projects with a capital cost of more than US$ 250 million could be done by one party on its own but would still have to be approved by the Owners’ Council. On this basis, it appears that neither party could sole risk even large expansions without the approval of the other party.

At the very least, such larger expansions would have to go through a consultation and approval process, giving BHPB and Rio the ability to reach an agreement not to sole risk expansions. It seems highly unlikely that, following this consultation and approval process, one party would decide to carry out an expansion on its own. This is because, as explained in Sect. 1.2.1 above and Sect. 1.2.4 below, as a result of the joint venture, BHPB and Rio would have the same production volumes and costs, and their market outlooks would converge. This would make it unlikely for the parties to have diverging views on whether or not to carry out an expansion, especially following a detailed consultation process.

This essentially leads to the conclusion that, BHPB and Rio would have to consult and agree on any expansion project. Only larger expansion projects (in excess of US$ 250 million) could be sole risked by one party, and even then only if approved by the other party and there are serious disincentives to expanding alone.

Moreover, the Japanese mills had a serious concern that the proposed joint venture would not only require the parties to coordinate all expansion plans, but would also give the parties the incentive to delay or cancel capacity expansions, hence driving up iron ore prices. There are several reasons for this:

- The joint venture would provide BHPB and Rio a mechanism to coordinate their expansion plans, with the knowledge that any capacity withholding strategy

[13] Section 6.4 of the Term Sheet.

would generate higher prices, considering that the parties would need to approve the other party's expansion plans and would therefore not need to worry about the other party expanding if they do not expand.

- The response of competing seaborne iron ore suppliers to BHPB's and Rio's reduced or delayed capacity expansions would not be sufficient to make a post-joint venture capacity withholding strategy unprofitable for the parties, for the following reasons:
  - Vale would not have the incentive to fill the gap left by the capacity withholding by BHPB and Rio.
  - Competitors other than Vale would be unable to fill the gap left by the capacity withholding of BHPB and Rio, as these competitors are too small to make enough of a difference to prevent prices from increasing and many of them do not have access to the infrastructure needed to compete on the seaborne markets.
  - New entrants face very high barriers to entry and expansion, especially after the global financial crisis.
  - Vertical integration would not defeat the capacity withholding strategy of BHPB and Rio.

For the above reasons, there was a concern that the joint venture would lead to BHPB and Rio further canceling or delaying capacity expansions, thus driving up seaborne iron ore prices. This concern related not only to BHPB's and Rio's announced capacity expansions at mines but also to announced capacity expansions for rail and port infrastructure.

For instance, at the time of the Commission's review, BHPB and Rio had announced significant capacity expansion plans for their respective ports: Port Hedland (BHPB) and Cape Lambert (Rio). The proposed joint venture was likely to have a major impact on these announced expansions. Specifically, at the time the joint venture plans were announced, BHPB had plans to expand its capacity at Port Hedland by developing the Outer Harbour. These expansion plans, which would add around 100 million tons per year of capacity at Port Hedland, came at an estimated cost of several billion Euros. Rio, for its part, had access to port infrastructure at Cape Lambert. Rio had plans to expand capacity at Cape Lambert by 100 million tons per year. However, because the expansion of Cape Lambert did not require the same extensive dredging as the planned expansion of Port Hedland, the expansion of Cape Lambert was considerably less expensive.

As the joint venture would give BHPB access to Rio's Cape Lambert, there was a considerable risk that BHPB would forego, or at least delay, its costly expansion at Port Hedland as a result of the joint venture. Indeed, the Japanese mills were concerned that BHPB would abandon or delay its plans to expand Port Hedland pursuant to a strategy of restricting production, through the joint venture, at BHPB's mines while increasing output at Rio's mines, which would be shipped from Cape Lambert. In addition, BHPB's Yandi iron ore products, which are mined at approximately the same distance from Port Hedland as Cape Lambert, could also be shipped through Cape Lambert. This would allow the parties to shift capacity

from Port Hedland to Cape Lambert, thus avoiding the need to expand Port Hedland.

This delay or cancellation of BHPB's planned expansion at Port Hedland would moreover perpetuate the risk of significant bottlenecks at the parties' Western Australian ports, especially as the markets were becoming tight again (after a temporary drop in demand as a result of the financial crisis) at the time of the Commission's review. These bottlenecks were expected to resurface as the iron ore markets continued to recover, especially considering the continuing increase in Chinese demand for seaborne iron ore. This meant that, unless BHPB and Rio carried out their respective planned expansions at both Port Hedland and Cape Lambert, bottlenecks at the Western Australian ports were expected to continue restricting supply and driving up seaborne iron ore prices (as they had done before the recession).

This would affect the steel industry and steel customers worldwide, who would suffer from the increased iron ore prices, and would also further hinder the prospects of smaller Australian iron ore suppliers, such as FMG, from effectively competing on the seaborne iron ore markets. FMG is currently the only smaller Australian iron ore supplier with its own railway and allocated capacity at Port Hedland. Bottlenecks at Port Hedland could therefore restrict FMG's ability to compete on the seaborne markets. Moreover, not only FMG, but also other Australian junior miners depend on the expansion of the Port Hedland Outer Harbour in order to enter the market.

1.2.3 Elimination of Competition Between BHPB and Rio in Terms of Product Quality

The quality of iron ore depends primarily on the iron (Fe) content and the nature and quantity of impurities contained in the ore. These characteristics are determined not only by the composition of the geological deposits from which the ore is mined, but also by the extraction strategy for the ore body and the processing of the mined ore by the iron ore supplier. This processing involves, inter alia, crushing, screening, beneficiation and blending. Iron ore suppliers thus compete with each other in terms of product quality by developing new, better and more efficient ways of extracting and processing their iron ore in order to create a final iron ore product that best fits the market.

Especially when iron ore markets are balanced, competition in product quality is fierce between BHPB and Rio, who have similar iron ore deposits with generally comparable characteristics, making the extraction strategy and processing of iron ore all the more important to gain a competitive edge over one another by differentiating their products in terms of quality. However, the joint venture would eliminate competition between BHPB and Rio in terms of product quality, as it would prevent any differentiation in product quality between the parties.

Indeed, BHPB and Rio announced that, following the creation of the joint venture, they intended to "standardize products as soon as practical".[14] This product standardization would likely result in the currently available BHPB and Rio brands being replaced by a few blends. Post-joint venture, BHPB and Rio would thus no longer offer their individual brands, but would market a limited range of exactly the same iron ore blends. This would eliminate any possibility of product differentiation between the parties and thus eliminate all competition between BHPB and Rio in terms of product quality.

Moreover, it was expected that, as a result of this product standardization, BHPB and Rio would offer a more limited range of products of generally lower quality, as they would likely blend their high-phosphorus, lesser quality ore with their high-quality products (because this would enable the parties to sell additional quantities of lower quality products, which would not be marketable as separate non-blended brands).

1.2.4 Reduction of Competition Between BHPB and Rio in Terms of Price

The Japanese mills had concerns that the joint venture would significantly reduce price competition between BHPB and Rio, for several reasons:

- The joint venture would reduce price competition between the individual marketing arms of BHPB and Rio. This is because, in addition to standardising the quality of the parties' iron ore products, the joint venture would further increase the already significant commonality of costs of BHPB's and Rio's iron ore. As BHPB and Rio would share costs on a 50–50 basis under the joint venture, they would essentially have the same production costs. These production costs generally make up around 90–95 % of total costs of finished iron ore products. Because BHPB and Rio would have split costs between them on a 50–50 basis, this would mean that BHPB and Rio would have around 90–95 % of their costs for finished iron ore products in common if they proceeded with the joint venture.

  Such a high degree of commonality of costs would increase the risk of price coordination between the parties, especially considering that their iron ore products would be completely homogenous post-joint venture, as a result of the planned product standardization.

  Moreover, reaching terms of such coordination would be further facilitated by the unusually high degree of price transparency on the seaborne iron ore markets. Not only are the price negotiations a transparent process; iron ore suppliers and customers also have a good visibility on other aspects of

[14] Section 5.1 of the Term Sheet.

competitive behaviour on the iron ore markets, including sales volumes, production capacity, capacity utilisation rates, planned capacity expansions, etc.

- The joint venture would likely align BHPB and Rio in terms of long-term mining/pricing strategies. This would reduce the scope for the iron ore customers to play BHPB and Rio off one another during benchmark price negotiations. Indeed, long-term mining/pricing strategies are a key factor of competition between BHPB and Rio during benchmark price negotiations. The joint venture would reduce the differences between BHPB's and Rio's long-term mining/pricing strategies. The coordination of output and expansion decisions of BHPB and Rio through the proposed joint venture (as explained in Sects. 1.2.1 and 1.2.2 above) would likely result in BHPB and Rio having similar long-term mining strategies. Moreover, the planned product standardisation would also reduce the scope for differentiation between the parties in terms of product quality. This would in turn align the parties' long- term pricing strategies, as there is a direct link between long-term mining and pricing strategies. As a result, the scope for iron ore customers to play BHPB's and Rio's competing pricing strategies off one another during benchmark price negotiations would be considerably reduced by the joint venture.

For the above reasons, the joint venture would likely significantly reduce price competition between BHPB and Rio, which would result in significant increases in the seaborne iron ore prices of both lump and fines:

- For lump, BHPB and Rio are the only two potential price setters in benchmark price negotiations, as Vale has only limited production of lump. The joint venture would thus reduce price competition between the only two competitors that can potentially set the benchmark price for lump.
- For fines, BHPB, Rio and Vale are seen as the only potential price setters in benchmark price negotiations. The joint venture would thus reduce price competition between two of the three possible price setters for fines. Moreover, post-joint venture, Vale would likely not have the incentive to compete during fines benchmark price negotiations.

1.2.5 Facilitation of Coordination Between BHPB and Rio by Means of Exchange of Sensitive Information Through the Joint Venture

The Japanese mills were concerned that the joint venture would result in an extensive exchange of sensitive information between BHPB and Rio, which would facilitate coordination between BHPB and Rio in terms of output, capacity, product quality and price.

This is because, in order for the joint venture to operate as described in the Term Sheet, sensitive information of BHPB and Rio would have to be exchanged within the framework of the joint venture's managing bodies, in particular the Owners' Council, the Manager and the Senior Executive Team. For example, the Owners' Council (which was to be composed of representatives of BHPB and Rio) would

need to approve budgets, business plans, expansion plans and product volumes and specifications, which would necessarily require discussions on each party's mining/production costs, production volumes, pricing and other kinds of sensitive information. It is difficult to see how this information could effectively be prevented from finding its way from the joint venture's managing bodies to the marketing arms of BHPB and Rio.

1.2.6 Facilitation of Coordination Between BHPB, Rio and Vale

The reduction of competition between BHPB and Rio, which would result from the joint venture, would also facilitate coordination between the Big Three iron ore suppliers. While the joint venture could facilitate coordination in all areas of competition between BHPB, Rio and Vale (such as output, capacity expansions, product quality, etc.), the risk of post-joint venture coordination between the Big Three would be particularly serious as concerns benchmark price negotiations, for fines in particular.

As explained in Sect. 1.2.4 above, the joint venture would reduce price competition between BHPB and Rio, two of the three possible benchmark price setters for fines. There was a concern that this would result in price coordination between the Big Three in post-joint venture benchmark price negotiations for fines. Moreover, even if the joint venture were not to lead to overt coordination between the Big Three, it would considerably increase the risk for them to tacitly collude. Indeed, the increased symmetry between BHPB and Rio that would result from the joint venture would significantly increase the risk of coordination between BHPB and Rio. As a result, Vale may find it profitable to adopt a wait-and-see approach during the fines benchmark price negotiations and simply follow the price agreed by BHPB or Rio. As a result, BHPB and Rio would not be constrained by Vale during benchmark price negotiations for fines, effectively making benchmark negotiations for fines similar to benchmark negotiations for lump, where BHPB and Rio are the only potential price setters.

1.3 The Conditions for Exemption Under Article 101 (3) TFEU Were Not Met

BHPB and Rio claimed that the joint venture would generate "production and development efficiencies" in excess of US$ 10 billion.[15] However, at least in public statements, BHPB and Rio were very vague on how the claimed US$ 10 billion of

[15]BHPB and Rio press release of 5 June 2009, available at: http://www.riotintoironore.com/documents/090605_Rio_Tinto_and_BHP_Billiton_announce_West_Australian_Iron_Ore_Production_Joint_Venture.pdf

efficiencies would be realized. In any event, the claimed efficiencies would not make the joint venture eligible for an exemption under Article 101(3) TFEU, as the four conditions for such an exemption were not met:

- The claimed efficiencies were unlikely to be substantiated;
- The restrictions imposed by the proposed joint venture would not be indispensable to generate the claimed efficiencies;
- Consumers would be unlikely to receive a fair share of any efficiencies generated by the proposed joint venture; and
- The proposed joint venture would afford BHPB and Rio the possibility of eliminating competition with respect to a substantial part of seaborne traded iron ore.

1.3.1 The Claimed Efficiencies Were Unlikely to Be Substantiated

The Japanese mills considered it highly unlikely that sufficient synergies could be substantiated to counteract the joint venture's harm to consumers, and were highly sceptical that any efficiency gains resulting from the joint venture would be even close to the US$ 10 billion figure advanced in the media by BHPB and Rio.

- The main claimed synergies appeared to be in the form of avoiding/delaying capacity expansions that would proceed absent the joint venture, rather than in the form of lower (marginal) extraction costs. In other words, these so- called "synergies" would flow from a reduction in infrastructure competition between BHPB and Rio and, therefore, a reduction in output. The effect would be that these "synergies" would result in higher prices to consumers, rather than lower prices. According to the Commission's own guidance, such "cost savings that arise from output reduction, market sharing, or from the mere exercise of market power" should not be taken into account for the purposes of Article 101 (3) TFEU.[16]
- Even based on the little information concerning the claimed efficiencies which is publicly available, the credibility of various efficiencies touted in the Term Sheet was highly doubtful, for the following reasons:
  - The Term Sheet mentions efficiencies resulting from shorter rail hauls and more efficient allocations of port capacity.[17] However, any efficiencies resulting from a coordination of rail and port infrastructure would likely be limited, as BHPB's and Rio's railway systems and ports cover geographically separate areas (with the exception of the territory of the Yandi mines). Aside from the Yandi mines, Rio's mines, railways and ports are all located in the

[16] European Commission guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements, OJ 2001 C3/115, para. 33; and European Commission guidelines on the application of Article 81(3) of the EC Treaty, OJ 2004 C101/97, para. 49.

[17] Sections 3.13(c) and 3.13(e) of the Term Sheet.

western Pilbara region, whereas BHPB's mines, railways and ports are all located in the eastern Pilbara region. This casts serious doubt on the claim that BHPB would benefit from transporting its iron ore via Rio's rail and port infrastructure, and vice versa.

– The Term Sheet also suggests that efficiencies would result from sharing equipment and staff "across the Pilbara".[18] However, due to the significant distances between the parties' mines in the Pilbara region, such sharing of equipment and staff would be unlikely to result in appreciable efficiencies outside the Yandi area (the only area where the mines of BHPB and Rio are adjacent). All other mines of BHPB and Rio are too far apart to be able to benefit from any significant sharing of equipment or staff.
– The Term Sheet touts efficiencies from the joint operation and expansion of the parties' Yandi mines.[19] Some synergies might indeed result from the joint operation of the parties' Yandi mines, although, in order to realise these synergies, the parties would need to carry out costly connection works between their infrastructures and may need to resolve any incompatibilities (resulting from the fact that BHPB and Rio use iron ore rail cars of different specifications). In any event, these synergies would unlikely have been significant.

1.3.2 The Restrictions Imposed by the Joint Venture Would Not Be Indispensable to Generate the Claimed Efficiencies

The restrictions imposed by the joint venture would not be indispensable, in that these restrictions would not be reasonably necessary to achieve the claimed efficiencies and these efficiencies could be achieved to a similar extent by less anticompetitive alternatives.[20]

For example, the Japanese mills were highly sceptical about the indispensability of the joint venture to generate the following claimed synergies:

• The Term Sheet claimed efficiencies resulting from blending opportunities.[21] However, some of the main opportunities to realize synergies from product blending lie in the blending of different BHPB brands or, alternatively, the blending of different Rio brands. In other words, this blending could be done without having to coordinate the parties' production under the joint venture.
• The Term Sheet also touted synergies resulting from the sharing of rail and port infrastructure between BHPB and Rio. However, there were likely to be less

[18]Section 3.13(i) of the Term Sheet.

[19]Section 3.13(h) of the Term Sheet.

[20]European Commission guidelines on the application of Article 81(3) of the EC Treaty, OJ 2004 C101/97, paras 73 *et seq*.

[21]Section 3.13(a) of the Term Sheet.

restrictive means than the joint venture to achieve such efficiencies. Moreover, such synergies would be readily available to BHPB and Rio if they were prepared to grant junior miners access to their railways. Instead, BHPB and Rio had consistently denied rail access to junior miners. The relevant counterfactual to consider was therefore that any synergies claimed from sharing railway infrastructure between BHPB and Rio could already arise, without the joint venture, by allowing junior miners access to the parties' railways. This would result both in more efficient use of infrastructure and increased output. By contrast, the joint venture would be more likely to frustrate such efficiencies by essentially creating a monopoly of iron ore infrastructure in Western Australia (by placing the infrastructures of BHPB and Rio under the same control), giving BHPB and Rio the ability to coordinate and delay investments in railway capacity and, in so doing, reduce the capacity of railway available to junior miners.

- Finally, regardless of the need for junior miners to obtain access to the parties' railway system, the parties could arguably achieve similar synergies by entering into arrangements to share rail and port infrastructure, rather than coordinating their entire production from mines to ports (although this would still give rise to serious competition concerns).

1.3.3 Consumers Would Be Unlikely to Receive a Fair Share of Any Efficiencies Generated by the Joint Venture

The Japanese mills had serious doubts that any efficiencies resulting from the joint venture would benefit the steel mills and, ultimately, end consumers (including in Europe). This is because, as indicated above, the claimed "synergies" would in fact seem predominately to take the form of reduced capacity investment, with the effect that total market output would be lower and market prices higher. Moreover, the post- joint venture seaborne iron ore markets would not be sufficiently competitive to force BHPB and Rio to pass synergies on to their customers. Not only were the seaborne iron ore markets already very concentrated, but the joint venture would significantly reduce competition between BHPB and Rio, and, moreover, competing iron ore suppliers (such as Vale) would be unwilling or unable to effectively constrain BHPB and Rio.

1.3.4 The Joint Venture Would Afford BHPB and Rio the Possibility of Eliminating Competition with Respect to a Substantial Part of Seaborne Traded Iron Ore

The joint venture would afford BHPB and Rio the possibility of eliminating competition in respect of a substantial part of seaborne traded iron ore.

As explained in Sects. 1.2.1, 1.2.2, 1.2.3, 1.2.4, 1.2.5, and 1.2.6 above, the proposed joint venture would seriously restrict, and in some cases eliminate,

effective competition between BHPB and Rio in relation to seaborne traded iron ore. Moreover, BHPB and Rio are leading – and arguably even (jointly) dominant – seaborne suppliers of iron ore. Based on 2007 estimates, BHPB and Rio together accounted for around 60 % of the contracted seaborne iron ore lump market and around 50 % of the contracted seaborne fines market. As the joint venture would account for nearly the entire iron ore production of BHPB and Rio, the elimination of competition resulting from the proposed joint venture would thus affect a substantial part of the iron ore traded on these markets.

Based on the above, the conditions for an exemption of the joint venture under Article 101(3) TFEU were clearly not met.

2 Review of the Joint Venture by the German Federal Cartel Office as a Concentration Under German Law

On 22 January 2010, i.e. around the same time as the Commission opened a formal antitrust investigation under Article 101 TFEU, BHPB and Rio formally notified their joint venture project to the German Federal Cartel Office ("FCO") as a concentration under the German merger rules. Indeed, under the German merger rules, the establishment of a joint venture company constitutes a concentration between the parties on the market(s) where the joint venture is active, regardless of whether the joint venture is full-function or not.

2.1 Jurisdiction of the FCO to Review the Proposed Joint Venture and Parallel Proceedings Before the Commission and the FCO

For the FCO to have jurisdiction, German law (the German Act against Restraints of Competition or "ARC") provides that the proposed concentration must have "domestic effect" in Germany. The FCO considered that the notified concentration had domestic effect, as the relevant geographic market for seaborne iron ore is world-wide, thus includes Germany.

Although German steel producers have traditionally purchased only minor quantities of Australian iron ore and sourced the majority of their iron ore needs from Brazil (mainly from Vale), the proposed joint venture in Western Australia would likely also affect steel producers in Germany. Indeed, in the world-wide iron ore markets, rising Australian iron ore prices will likely have a knock-on effect on Brazilian ore prices. The FCO also noted that each of BHPB and Rio achieved a total turnover of over €1 billion in Germany.

As a result, the proposed joint venture was subject to a parallel assessment by the Commission – as an agreement restrictive of competition under Article 101 TFEU –

and by the FCO – as a concentration under the German merger rules. Such parallel reviews by the two authorities is possible, as only a merger proceeding under the EU Merger Regulation (but not an Article 101 investigation) precludes a review by the national competition authorities under their national merger control laws. However, the BHPB/Rio joint venture case appears to be the first time in the modern era that a transaction was subject to concurrent reviews by the Commission under Art. 101 TFEU and by a EU Member State competition authority under its merger control laws.

Although the legal bases for their assessment were different (Art. 101 TFEU and the merger control rules of the German ARC), the Commission and the FCO cooperated during their investigations, by exchanging views and informing each other of the status of their respective proceedings. Van Bael & Bellis represented the interests of the Japanese steel producers in both investigations.

Under the German merger control rules, the FCO has a total of 4 months from the submission of a complete notification to review the proposed concentration, including a review period of 1 month in the first phase of the investigation plus an additional period of 3 months if the FCO decides to open a second-phase investigation. This 4-month time-limit for review by the FCO would normally have expired on 22 May 2010. However, German law provides for the possibility that the review period is extended with the consent of the notifying parties. The FCO indeed obtained BHPB's and Rio's consent for several extensions of this time limit. It would appear that BHPB and Rio were willing to agree to these extensions in order to avoid "forcing" the FCO to take a decision prohibiting the transaction, before the Commission had taken a position. The parties were perhaps hoping that the Commission would take a favorable view of the proposed joint venture under Article 101 TFEU and that this would influence the FCO's decision in the parallel merger proceedings.

However, on 14 October 2010, i.e. before the Commission had formally expressed a view, the FCO informed BHPB and Rio that it intended to prohibit the concentration and that it would shortly issue a statement of objections.

On 18 October 2010, BHPB and Rio announced that they had abandoned their joint venture plans in light of strong resistance from regulators, including the European Commission and the German FCO. The parties withdrew their notification to the FCO on the same day, probably so as to avoid the issuance of a statement of objections by the FCO.

Thus, after lengthy investigations, neither the German FCO nor the Commission had the opportunity to formally issue objections against the planned transaction, although it is clear that both authorities were poised to do so.

2.2 *Assessment of the Proposed Joint Venture by the FCO Under the German Merger Control Rules*

BHPB and Rio notified their proposed joint venture to the FCO as a concentration under the merger control rules of the German ARC. Upon their application, the FCO granted two of the Japanese steel producers (as well as a few other interested third parties) so-called "third party status" in the merger proceedings. Official third parties have the right to access the non-confidential parts of the FCO's file and have the right to be heard by the FCO.

As regards the substantive assessment of notified concentrations pursuant to Article 36 of the German ARC, the FCO has to prohibit a concentration which is expected to result in the creation of a dominant market position or in the strengthening of a pre- existing dominant position, unless the parties to the concentration are able to prove that the concentration will also lead to improvements of the conditions of competition and that these improvements outweigh the negative effects of dominance.

As representatives of the Japanese steel producers, and in particular of two official third parties admitted to the merger proceedings, Van Bael & Bellis had meetings with the FCO and made several submissions, showing that the proposed joint venture would restrict competition between BHPB and Rio and thereby lead to the creation and/or strengthening of dominant positions on the relevant world-wide markets for seaborne iron ore lumps and fines.

In October 2010, the FCO reached the view that the proposed concentration would create and strengthen dominant positions on relevant iron ore markets, and informed the notifying parties as well as the official third parties by letter that it intended to issue a statement of objections with a view to prohibiting the notified concentration.

According to a summary of its analysis published by the FCO,[22] the FCO took the view that the joint venture would result in the creation of single firm dominance by BHPB/Rio on the world-wide market for seaborne iron ore lumps and that it would strengthen an existing position of collective dominance between the "Big Three" – Vale (Brazil), BHPB and Rio – on the world-wide market for seaborne iron ore fines.

2.2.1 The Creation of Single Firm Dominance by BHPB and Rio on the Market for Seaborne Iron Ore Lumps

According to the FCO, the joint venture would have resulted in the creation of single firm dominance by BHPB/Rio on the world-wide market for seaborne iron ore lumps.

[22] See Case summary of 24 January 2011 published on the website of the FCO: http://www.bundeskartellamt.de/wEnglisch/download/pdf/Fallberichte/B01-010-10-english.pdf?navid=42

The FCO considered that the world-wide market for seaborne iron ore lumps is already characterized by a high level of concentration and stable market shares of the main players. According to the FCO, BHPB and Rio already form a duopoly on this market with a combined market share of 55 % – if short-term supply relationships, i.e. sales on the spot market, are also taken into account in establishing the total market size. The FCO found that, when based only on long-term supply relationships, the parties' combined market share is even higher. However, according to the FCO, due to the availability of only insufficient data, no separate market volume could be ascertained for long-term supply relationships, with the result that the market volume taken as a basis for the calculation of market share also included short-term supply relationships, which leads to a lower share of 55 %. The FCO also pointed out that there has been no considerable change in market share in the last few years and that leading industry analysts expect market shares to remain stable in the future.

Even in this concentrated market, the FCO considered that, pre-joint venture, there was still some scope for remaining competition between BHPB and Rio. However, the FCO found that the proposed production joint venture would eliminate this remaining competition, as through the joint venture the parties would coordinate about 90 % of their relevant production on the iron ore markets, standardize their products and create cost commonality for about 90 % of their total costs. As a result, the parties would have offered on the market virtually identical volumes of identical products which have been produced at identical costs. In the FCO's view, this would have led to the creation of a competitive unit between BHPB and Rio, from which, given the parties' common interests, no relevant competition could be expected, despite the fact that their marketing companies would have continued to operate separately.

2.2.2 The Strengthening of an Existing Position of Collective Dominance of Vale, BHPB and Rio on the Market for Seaborne Iron Ore Fines

Furthermore, the FCO considered that the proposed joint venture would strengthen an existing position of collective dominance between the "Big Three" iron ore producers – Vale (Brazil), BHPB and Rio – on the world-wide market for seaborne iron ore fines.

According to the FCO, on this market there is already an uncompetitive oligopoly between the parties (BHPB and Rio) and Vale, whose scope of action is not sufficiently limited by external competition. Together with Vale, the parties have a combined share of 65 % based on both long-term supply relationships and sales on the spot market. As with regard to iron ore lumps, the market share of this oligopoly in iron ore fines would be even higher if only long-term supply relationships are taken into account. According to the findings of the FCO, the market for seaborne iron ore fines is characterized by a high supply concentration, long-term and stable supply conditions, high barriers to entry and low price elasticity of demand. Due to

the structure of this market, the FCO considered that permanent uniform conduct by the members of the oligopoly would have been likely. In particular, high market transparency, which is further increased by regular press releases of the oligopoly members on topics relevant to competition, facilitates effective coordination and enables oligopoly members to implement sanctions for deviations.

The FCO found that, in spite of certain asymmetries, in particular between BHPB and Rio on the one hand and Vale on the other, and a strong increase in demand, no significant individual deviation by any of the oligopolists from coordinated price and volume equilibria could be observed in recent years. Within the oligopoly there is a strong incentive to coordinate volume increases so as to maintain a tight supply and thereby keep prices above competitive levels and achieve high profits for the oligopolists in the long term. The FCO considered that this incentive clearly outweighed the weaker incentives of individual oligopoly members to deviate from the coordinated equilibria in order to maximize short-term profits.

The FCO concluded that the proposed concentration (i.e. the joint venture) between BHPB and Rio would have strengthened the existing collective dominance of the Big Three suppliers in iron ore fines. The number of independently operating members of the oligopoly would have been reduced from three to two, thereby further increasing transparency in the market and reducing the costs of coordination. The already limited incentives to deviate from the coordinated equilibria would have been weakened further.

Under the German merger control rules, a concentration which will create or strengthen a dominant position has to be prohibited, unless the parties prove that the concentration will also improve competitive conditions and that these improvements will outweigh the negative effects of dominance. However, the FCO considered that BHPB and Rio had not proven that the claimed synergies resulting from the joint venture, i.e. alleged cost savings and increases in output, would outweigh the negative effects of the concentration on competition in iron ore. In particular, according to the FCO, the alleged advantages would not have benefited consumers, but only the parties and their shareholders, and could not be taken into account as "improvements of competitive conditions" outweighing the negative effects of the concentration under German law.

3 Conclusion

In conclusion, whilst neither the German FCO nor the European Commission had the opportunity to adopt a formal decision or even issue a statement of objections against the proposed BHPB/Rio joint venture, it is clear that both competition authorities had internally reached a negative view about the transaction and would have issued objections against it, had the parties not rapidly decided to abandon their joint venture project and withdrawn their merger notification to the FCO. Indeed, shortly after the FCO had informed the parties of its intention to issue

a statement of objections, and apparently after the European Commission had also informally told the parties that it had serious concerns about the planned transaction, BHPB and Rio decided to abandon their joint venture project and acknowledged in a press statement that this decision was taken after both parties had "*been advised that the proposal would not be approved in its current form*" by regulators including the European Commission and the German FCO.[23]

While no formal decision on the proposed BHPB/Rio joint venture has been issued, neither by the European Commission nor the German FCO, this case is nonetheless noteworthy for at least two reasons that set it apart from other cases handled by the European Commission under Article 101 TFEU:

- It is very rare for European competition authorities to oppose pure production joint ventures such as the BHPB/Rio joint venture, let alone a production joint venture like the one at hand, where the production takes place entirely outside of the EU and only relatively small amounts of the jointly produced products would likely be sold in the EU;
- The proposed BHPB/Rio joint venture would appear to be the first case in the post-modernization era that was reviewed concurrently by the European Commission under Article 101 TFEU and by a Member State competition authority under its merger control laws. This case points to the need to amend the EU merger control legislation to prevent the recurrence of such situations inconsistent with the "one-stop-shop principle in the future.

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[23]Press statement of Rio Tinto of 18 October 2010: http://www.riotinto.com/media/18435_media_releases_19664.asp

Chapter 11
Putting Limits on Extra-Territorial Coverage of Competition Laws in the Age of Global Supply Chains: Comparison of the US and Japan

Toshiaki Takigawa

Abstract This comment, through comparing two representative extra-territorial antitrust cases in the US and Japan, shows that, in the age of global supply-chains, competition agencies' enforcement on conduct overseas (based on the effect doctrine) needs to receive proper limitation. Each competition agency needs to limit its law enforcement to cases conducted overseas, which have direct (and substantial effect) on consumers of the agency's home country. Regarding this "direct" effect, price-fixing of components conducted in foreign countries would normally be interpreted as lacking in direct effect on home countries to which finished products are exported. Moreover, competition agencies of MNEs' home countries would normally be advised to refrain from extending protection under the competition law to the MNEs' foreign subsidiaries since the subsidiaries are entitled to seek protection under the competition laws of respective foreign countries where they are incorporated.

Keywords Extra-territorial application • MNEs • FTAIA • Global supply-chains • Direct effect

1 Introduction

The chapter by Jean- François Bellis (2016) excellently demonstrates the need for competition agencies to intervene into overseas joint-ventures performed by multinational enterprises (MNEs). The EU Commission (and German Cartel Office) intervened into the Rio Tinto/BHP Billiton joint venture, although the venture not only took place outside the EU but also involved only a small amount of the jointly produced products sold within the EU. Notwithstanding these facts, the

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_11

Commission's intervention was deemed legitimate, Mr. Bellis indicates, on the grounds that production cut by Rio Tinto/BHP Billiton affected global supply-and-demand, resulting in raised prices in the EU. In short, the combination of a small degree of direct effect and a considerable indirect-effect legitimized Commission's intervention into this case. Nevertheless, the question remains as to how much (or direct) degree of effect should be deemed sufficient for legitimizing a competition agency's intervention into cartels or joint-ventures conducted outside the agency's home country.

This comment discusses on how to put limits on competition agencies' enforcement on conduct by firms located abroad. For this purpose, this commenter compares extraterritorial enforcement by the US antitrust agencies with that of the Japanese competition agency.

Putting limits on extraterritorial enforcement does not signify endorsement of inhibited law enforcement against international cartels/joint ventures by MNEs. Still, competition agencies in developed countries (in particular, the US, the EU and Japan) need to bear in mind that considerable number of developing countries (e.g. Indonesia, Malaysia and Singapore) have equipped themselves with well-established competition laws, enforced by reputable competition agencies. Competition agencies worldwide, therefore, need to coordinate their enforcements on cartels. In order to facilitate effective coordination, competition law enforcement based on the effect doctrine needs to be supplemented by standards limiting the reach of the effect doctrine. This is because, in today's globally connected world, MNEs have established global supply-chains, through which MNEs' conduct affects entire world, triggering duplicated enforcement by numerous competition agencies, which, without coordination, leads to wasted energies as well as confusion.

International coordination among competition agencies, therefore, is now called for. International cooperation in the enforcement on cartels, however, is at a nascent stage at international institutions, most importantly at the International Competition Network (ICN). Moreover, international coordination, in some cases, would be difficult due to divergent interests among countries. Therefore, while endeavoring to develop the international cooperation, competition agencies need to set limitation to the effect doctrine, regarding how much direct and substantial effect is sufficient for legitimizing a competition agency's law enforcement. A great portion of international cartels/joint ventures concern natural resources. Even so, the topic of this comment concerns cross-section industries.

2 Limitation to the US Antitrust Law Enforcement on Conduct Overseas: The Direct (and Substantial) Effect Requirement

The Foreign Trade Antitrust Improvements Act (FTAIA)[1] of the US offers the most prominent example of limitation to enforcement of competition laws on conduct overseas. Indeed, the US Congress inaugurated (in 1982) the FTAIA with the aim to prevent "unreasonable interference with the sovereign authority of other nations."[2] Competition agencies worldwide need to learn from the US's experience of enforcing the FTAIA.

The FTAIA, in essence, limits application of the US antitrust law to the following two situations: (1) "import commerce"; (2) the targeted conduct has "a direct, substantial, and reasonably foreseeable effect" on US commerce. Between these two requirements, the limiting effect on law enforcement stems mostly from the second one – the "direct effect" requirement.[3]

Nevertheless, the "direct effect" requirement allows wide-range of interpretations. Typical discrepancies in interpretations occur in case of price fixing (conducted outside the US) of manufacturing parts, some of which are imported to the US, incorporated into finished products.

Broad and narrow interpretations of the "direct effect" coexist. The US antitrust agencies (Department of Justice [DOJ] and the Federal Trade Commission [FTC]) expressed the broad interpretation in their amicus brief for *Motorola* versus *Au Optronics*.[4] In this case, Motorola claimed damages based on overcharges on liquid-crystal display (LCD) panels that were incorporated into Motorola cellphones sold in the US. Motorola alleged that the LCD panel manufacturers globally conspired to fix the price of LCD panels, in violation of the US antitrust law: Section 1 of Sherman Act. In Support of Motorola's position, the DOJ put forth the broad interpretation of the direct effect: "direct" means only "a reasonably proximate causal nexus"; "the existence of several steps in the causal chain does not alone render an effect indirect or too remote." The DOJ, on this basis, concluded that "the conspiracy's effect on U.S. commerce in cellphones is direct."[5]

Prior to the Motorola case, the broad interpretation of direct effect had also been expressed by the *Potash* (*Minn-Chem*) decision: the Circuit Court expressed that the Potash producers' restrictions on Chinese purchasers is the "direct...cause of the subsequent price increases in the United States."[6]

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[1] 15 U.S. Code § 6a.

[2] *F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 164 (2004).

[3] Substantial and reasonably foreseeable effect will be almost always identified when direct effect takes place.

[4] Brief for the United States and the Federal Trade Commission as Amici Curiae in Support of Panel Rehearing or Rehearing En Banc (April 24, 2014).

[5] Id. at 18 (9)–19 (10).

[6] *Minn-Chem, Inc. v. Agrium, Inc.*, 683 F.3d 845, 858–59 (7th Cir. 2012).

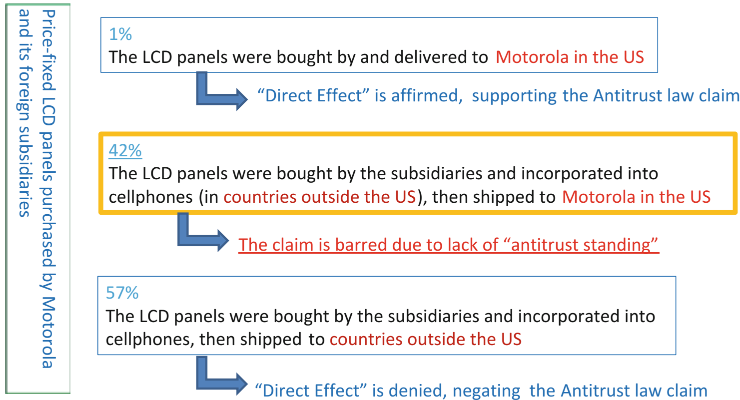

Fig. 11.1 Posner judgment on Motorola's claim for damage regarding LCD panels

In opposition to these governmental opinions, Judge Posner (and the other two judges), in the appellate court decision of the same Motorola case, denied the existence of "direct effect", excepting for the LCD panels directly purchased by Motorola in the US (occupying merely 1 % of purchase by Motorola and its subsidiaries) (See Fig. 11.1).[7] Regarding the rest (99 % of purchase), the Judge opined, first, only the following LCD panels might support Motorola's claim for damage: panels which are incorporated into Motorola cellphones (and other products), and then are shipped to Motorola and are sold in the US, for which Motorola "did none of the manufacturing or assembly of these phones[8]" (occupying 42 % of purchase). The judge, then, concluded that Motorola's claim regarding this 42 % is barred by the "direct effect" requirement of FTAIA.

Judge Posner (and two other judges) in this initial decision had explained the reasoning for denying the "direct effect" as follows: The price fixers sold the LCD panels abroad to foreign companies (the Motorola subsidiaries), and therefore "[t]he effect of component price fixing on the price of the product of which it is a component is indirect".[9] This reasoning is straightforward, denying all the claims on components assembled by foreign subsidiaries of US parent companies.

However, this case did not end here. In response to Motorola's petition (as well as the DOJ's amicus brief) for an *en banc* rehearing, Judge Posner (and two other judges) agreed to reconsider, vacating the initial decision. The ensuing new decision[10] maintained denial of Motorola's claim, but refrained from denying direct effect, noting that this case does not fall into a typical case for which direct effect is

[7] *Motorola Mobility LLC v. AU Optronics Corp.*, 775 F.3d 816 (2014) (7th Cir. 2014) (November 26, 2014; Amended, January 12, 2015).

[8] Id.

[9] *Motorola Mobility LLC v. AU Optronics Corp.*, 746 F.3d 842 (7th Cir. 2014) (March 27, 2014).

[10] *Motorola Mobility LLC v. AU Optronics Corp.*, 775 F.3d 816 (2014) (7th Cir. 2014) (November 26, 2014; Amended, January 12, 2015).

denied: the "situation in which action in a foreign country filters through many layers and finally causes a few ripples in the United States."[11] In this case, "[t]he price fixers had [...] been selling the panels not in the United States but abroad, to foreign companies (the Motorola subsidiaries) that incorporated them into cellphones that the foreign companies then exported to the United States for resale by the parent company, Motorola. The effect of fixing the price of a component on the price of the final product was therefore less direct than the conduct in *Minn-Chem*, where 'foreign sellers allegedly created a cartel, took steps outside the United States to drive the price up of a product that is wanted in the United States, and then (after succeeding in doing so) sold that product to U.S. customers.'"[12]

In consequence, Posner "assumed" that the requirement of direct effect has been satisfied. Still, he maintained the denial of Motorola's claim, on the ground that Motorola lacked "antitrust standing" (i.e., having connection to the violation, to the degree sufficient to have right to sue). This is because it is the foreign subsidiaries (not Motorola) that suffered damage from the price-fixing, and therefore "Having submitted to foreign law, the subsidiaries must seek relief for restraints of trade under the law either of the countries in which they are incorporated or do business or the countries in which their victimizers are incorporated or do business. The parent has no right to seek relief on their behalf in the United States."[13] (Supreme Court denied *certiorari* for this case.[14])

This commenter considers that the narrow interpretation of the "direct effect" together with the stance on "standing" (expressed by Judge Posner most forcibly in his initial decision, subsequently weakened but still largely intact in the new decision) is more appropriate than the broad interpretation (expressed by the DOJ). This is because Posner's (rather than DOJ's) standpoint appropriately takes into consideration the nature of global supply-chains adopted by today's MNEs. Specifically, MNEs have foreign suppliers (including the MNEs' foreign subsidiaries) produce parts, which MNEs incorporate into finished products (such as automobiles or smart phones); MNEs, next, export the finished products to numerous countries, including the MNEs' home countries. Cartels conducted overseas on parts, therefore, invariably exert some degree of price-raising effect on finished products in the MNEs' home countries. However, almost all of the effects on the home country are indirect, since the cartel concerned the parts (not the finished products), which took place in foreign countries, most of which have competition-law agencies. Hence, it is right to deny direct-effect (or alternatively "standing") regarding the 47 % of the alleged Motorola imports (See Fig. 11.1).[15]

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[11]Citing *Minn-Chem*, *Inc*. *v*. *Agrium*, *Inc*., 683 F.3d at 860.

[12]Id.

[13]*Motorola Mobility LLC v. AU Optronics Corp*., 775 F.3d 816 (2014) (7th Cir. 2014).

[14]Supreme Court, June 15, 2015, available at http://www.supremecourt.gov/orders/courtorders/061515zor_32q3.pdf (accessed November 9, 2015).

[15]Regarding basically the same facts of this 7th Circuit decision, the 9th Circuit judged on the criminal prosecution (which cover sales to not only Motorola but also Dell, Hewlett Packard,

By contrast, the DOJ's amicus opinion blurs the distinction between direct and indirect effects, resulting in treating virtually all effects as direct, regarding component cartels conducted overseas.

3 Lack of Limitation to the Effect Doctrine in the Japanese Competition Law Enforcement: The Cathode Ray Tube Case

In contrast to the US antitrust-agencies and courts, the Japanese competition-agency (and courts) has yet to establish any standard for limiting the reach of the Japanese competition law to conduct overseas.

The Japanese competition agency (the Fair Trade Commission: JFTC) has been enforcing the Japanese competition law (Antimonopoly Act: AMA) to conduct outside Japan, effects of which takes place inside Japan. The JFTC has never officially proclaimed adherence to the effect doctrine, but actual cases testify to the JFTC's adherence to the doctrine: Rio Tinto/ BHP Billiton joint venture (2010)[16]; Marine horse cartel (2008)[17]; and most prominently Cathode ray tube (CRT) cartel (2009 and ongoing).[18]

The problem about JFTC's extra-territorial enforcement is that the JFTC has not put any limit to its AMA enforcement on conduct overseas that exerts some effects on Japanese consumers (or customers). In other words, the JFTC has neither proclaimed nor practiced the "direct effect" limitation to the effect doctrine. I analyze this situation regarding the Cathode ray tube (CRT) cartel case.

Apple and other US information technology companies) by the DOJ, sustaining the DOJ's prosecution – *United States v. Hui Hsiung*, 758 F.3d 1074 (9th Cir. 2014). The 7th Circuit (Judge Posner) and the 9th Circuit decisions are not contradictory, since both decisions admit existence of either import trade (in case of the 9th Circuit decision) or direct effect to the United States for at least a part of the entire trade. Supreme Court denied *Certiorari* for both the 7th Circuit and the 9th Circuit decisions: *supra* note 14.

[16] JFTC Press Release on Rio Tinto/ BHP Billiton (October 18, 2010), Japanese version available at http://www.jftc.go.jp/houdou/pressrelease/h22/oct/10101802.html (accessed December 21, 2014).

[17] JFTC Remedy order, *Marine horse* (February 20, 2008), 54 Shinketsushu 512.

[18] JFTC Remedy order, *CRT manufacturers* (October 7, 2009), 56 (2) Shinketsushu 71. Samsung SDI and MT Display, in 2010, appealed the JFTC remedy order (and fine-imposition order) to the JFTC Hearing, which led to JFTC Hearing Decision (2015), followed by Tokyo High Court Decision (2016).

3.1 Cathode Ray Tube Case: JFTC Remedy Order and Subsequent Hearing Decision followed by the High Court Decision

The cathode ray tube (CRT) case concerns price fixing of CRTs, committed by CRT manufactures incorporated and located in Southeast Asian countries. CRTs are used as a major component in televisions (hereinafter "CRT TVs"). The CRT manufacturers met in Indonesia (in 2002) and agreed to fix their prices.[19] These price-fixers consisted of subsidiaries (incorporated in Southeast Asian countries) of Japanese parent companies (including the joint venture between Panasonic and Toshiba: MT Display Co.), as well as subsidiaries of non-Japanese parent companies (including Samsung SDI Co. and LG Philips Co.).

Majority of these CRTs had been purchased by subsidiaries (incorporated in Southeast Asian countries) of Japanese TV manufacturers (including Sharp and Victor), which incorporated the purchased CRTs into TVs, which are then sold to customers in Asian countries.[20] Although the Japanese customers are included among the TV customers, their weight is exceedingly low, since only few Japanese customers purchase CRT TVs, which are technically superseded by liquid-crystal display (LCD) TVs.

The JFTC, in its remedy order, determined that the price fixing violated the Japanese competition law (the AMA), constituting illegal restraint of trade prescribed at Article 2 (6) of the AMA. The JFTC, consequently, inflicted remedy order on two companies incorporated outside Japan: MT Display [Japanese subsidiary] and Samsung SDI [Korean subsidiary]. At the same time, the JFTC imposed fines on six companies located (and incorporated) outside Japan, including three subsidiaries of MT Display.[21]

MT Display and Samsung SDI appealed the JFTC orders (the remedy order and the fine-imposition order) to the JFTC Hearing procedure, whereby independent Hearing Examiners conducted a court-like proceeding. The defendants insisted that the JFTC lacked jurisdiction on this case because purchasers of the price-fixed CRT resided outside Japan. However, the Hearing decision[22] supported the JFTC for its jurisdiction, on the grounds of doctrine of single-entity between parents and subsidiaries: "CRT TV manufactures in Japan and their subsidiaries outside Japan has purchased price-fixed CRTs as an inseparable single entity".[23]

[19] 56 (2) Shinketsushu 71, at 74.

[20] Id. at 73.

[21] 56 (2) Shinketsushu 175.

[22] JFTC Hearing Decision of CRT Cartel Case (May 29, 2015), Japanese version only available at http://www.jftc.go.jp/houdou/pressrelease/h27/may/150529.html (accessed August 23, 2015).

[23] Id.

3.2 Is the Effect on Japanese Consumers Direct Enough to Legitimize JFTC's Intervention?

In this case, not only CRTs but also CRT TVs (for which CRTs are major components) are manufactured outside Japan, in Southeast Asia. Therefore, showing of effect on Japanese consumers (or customers) is required to legitimize JFTC's intervention. The effect, indeed, is witnessed regarding CRT TVs imported to Japan. Nevertheless, degree of the effect is miniscule, because only an exceedingly small portion of CRT TVs (manufactured in Southeast Asian countries) are exported to Japan; a vast majority of CRT TVs are exported to other Asian countries (See Fig. 11.2).

Japan does not have the equivalent of the US FTAIA for limiting its extraterritorial application, thus lack of direct (or substantial) effect does not legally negate JFTC's jurisdiction over conduct overseas. Nevertheless, policy-wise consideration would adhere to the standpoint expressed by the US FTAIA.

In this regard, the crucial point is whether the effect on the Japanese consumers (regarding the small amount of TVs exported to Japan) is direct (and substantial) enough. On this point, this case's situation is the same as that of the US Motorola case (regarding the 49 % portion – See Fig. 11.1). In both cases, the component cartels are conducted outside the home countries (the US and Japan). Moreover, finished products (which incorporate the components) are also manufactured outside the home countries.

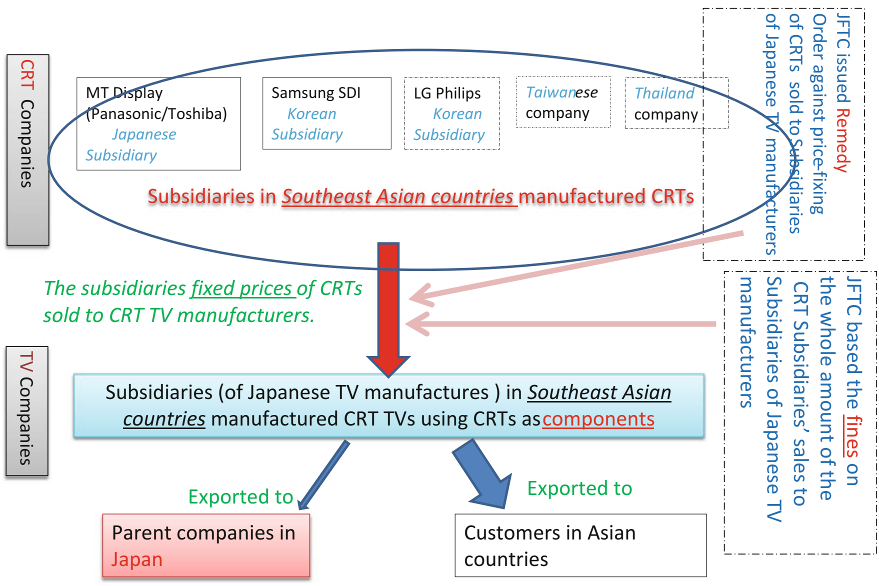

Fig. 11.2 JFTC's charge against the CRT companies on their price

Just as in the case of the Motorola decision, the effect on Japanese consumers caused by the CRT price fixing is deemed only indirect as well as unsubstantial. This finding would lead to negating legitimacy of JFTC's intervention, if Japan followed the direct-effect requirement adopted by the US FTAIA. Moreover, the fact that the Southeast Asian countries (where CRT price-fixing took place and/or price-fixed CRTs were sold or exported) have established their own competition agencies (Indonesia, Malaysia, Thailand and other countries) further weakens the rationale for the JFTC's intervention into this case.

The three defendants—MT Display, Samsung (parent) and Samsung (Malaysian subsidiary)—appealed the JFTC hearing-decision to the Tokyo High Court, which, in January and April 2016, issued three separate decisions for each of three defendants: Tokyo High Court Decisions (29 January 2016; 13 April 2016; 22 April 2016). The companies appealed the High Court Decision to the Supreme Court, whose proceeding is on-going (on August 2016).

The High Court decisions basically supported the JFTC Hearing-decision; nevertheless the High Court expressed illuminating opinions on the AMA's extra-territorial reach. First, the AMA (for its article regarding price-fixing) is applicable when "Purchasers [of the price-fixed merchandise] are located in Japan." (Tokyo High Court decision of 13 April 2016 on MT Display) Second, "The core element of a purchaser is who decides the purchasing decision." Third, "Japanese parent companies have decided [purchasing conditions] of CRT tubes purchased by the subsidiaries located overseas." In conclusion, the High Court supported the JFTC decision regarding the remedy- order against the defendants.

The Tokyo High Court also supported the JFTC's imposition (and the amount calculation) of fines against the defendants. The High Court opined: The CRT tubes supplied outside Japan comprise the merchandise of illegal price-fixing; therefore the CRT tubes supplied outside Japan may not be excluded from calculation of fine amounts.

3.3 Is the Amount of Fines Imposed on the Foreign Companies Legitimate?

In accompaniment to the remedy order, the JFTC issued a fine-imposition order against four foreign companies, composed of three subsidiaries of MT Display (all are incorporated in Southeast Asian countries) and LG Philips (Korean company's subsidiary incorporated in a Southeast Asian country).[24]

The JFTC calculated the amount of fines from the sales amount of the CRTs sold by the price-fixers to the Japanese manufacturing subsidiaries located in Southeast

[24]JFTC fine-imposition order against MT Picture Display Indonesia Co. et al. (October 7, 2009), 56 (2) Shnketsushu 173.

Asian countries.[25] These subsidiaries made use of the purchased CRTs to manufacture CRT TVs, which the subsidiaries exported to (1) Japanese parent company, and (2) customers in Southeast Asian countries (See Fig. 11.2).

The problem with these fines is that the sales (from which the fine figures are calculated) include those to customers in Southeast countries, whereas harm to Japanese customers (consumers) is attributed only to TVs exported to Japan (See Fig. 11.2). Even if the JFTC were legitimized to intervene into this case on the grounds of indirect effects on Japanese consumers, the effects needs to be restricted to those on Japanese customers, and only a miniscule percentage of TVs (in which price-fixed CRTs are components) are exported to Japan. The JFTC committed an evident error in coming up with the fine amount from the sales amount which includes those to customers outside Japan.

3.4 Is the JFTC's Intervention Legitimized for Protecting the Interests of Japanese Parent Companies?

The JFTC issued remedy order as well as fine-imposition order, regarding all the CRTs exported to the Japanese subsidiaries located in Southeast Asian countries. The JFTC, then, may have considered its intervention necessary, for the reason that Japanese parent companies share the same interest with their subsidiaries (TV manufactures) in Southeast Asian countries, and the subsidiaries, as customers to the price-fixed CRTs, suffered losses due to the price-fixing.[26] Indeed, subsequent Hearing decision[27] affirmed the JFTC's jurisdiction on the ground of doctrine-of-single-entity between parents and subsidiaries.

However, this rationale for the JFTC's jurisdiction contains three weak points. First, competition laws are generally grasped to have as their objectives to protect consumer welfare, not producers' interests. The JFTC, by championing interests of Japanese manufactures (rather than consumers) has presented a standpoint markedly at odds with the general global trend.

Second, in this case, the protected manufacturers are not purely Japanese companies, but MNEs, whose interests are dispersed all over the world; overseas subsidiaries' interests are not identical with Japan's public interests.

Third, MNE parent companies, in utilizing global supply chains, hold subsidiaries worldwide: Legitimizing the JFTC's intervention into cases where Japanese MNEs' foreign subsidiaries suffered losses would end up broadening the area of JFTC's interventions worldwide. Moreover, for seeking compensation for the

[25] Id.

[26] See Ochi (2012), p. 53 (Commenting that a subsidiary's profit loss leads to loss for its parent company, and thus the competition agency may be deemed to have jurisdiction over the parent/subsidiary group.).

[27] *Supra* note 22.

losses, the Japanese subsidiaries are entitled to seek interventions by the competition agencies (or bring damage suits to courts) in Southeast Asian countries where the subsidiaries are incorporated and located. Judge Posner is right in denying single-entity doctrine for this circumstance: “Having chosen to conduct its LCD purchases through legally distinct entities organized under foreign law, it cannot now impute to itself the harm suffered by them.”[28]

The Tokyo High Court decision affirmed the JFTC’s jurisdiction on the grounds that the Japanese parent-companies were responsible for the decision of purchasing the CRT tubes, without recognizing any amount of CRT TVs imported into Japan; therefore the decision essentially protects Japanese companies’ interest when the companies are responsible for the purchasing decision, although the purchase was conducted by their subsidiaries abroad. This stance on extraterritorial application has never been adopted by either American or European agencies or courts.

4 Conclusion

In the age of global supply-chains, competition agencies’ enforcement on conduct overseas (based on the effect doctrine) needs to receive proper limitation. Otherwise, each competition agency’s jurisdiction would be extended to worldwide. For this purpose, each competition agency needs to limit its law enforcement to cases conducted overseas, which have direct (and substantial effect) on consumers of the agency’s home country. Regarding this “direct” effect, price-fixing of components conducted in foreign countries would normally be interpreted as lacking in direct effect on home countries to which finished products are exported.

Moreover, competition agencies of MNEs’ home countries would normally be advised to refrain from extending protection under the competition law to the MNEs’ foreign subsidiaries since the subsidiaries are entitled to seek protection under the competition laws of respective foreign countries where they are incorporated.

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[28] *Motorola Mobility LLC v. AU Optronics Corp*., 775F.3d 816, 822 (2014) (7th Cir. 2014).

Part V
Special Agreements and Energy

Chapter 12
Special Agreements and Energy: Filling the Gaps

Michael Hahn and Kateryna Holzer

Abstract This chapter examines the patchwork of regulatory responses in the field of trade and investment to the current energy challenges and reflects on the recent developments in relevant international fora in terms of their ability to take the regulatory framework for energy a step further in serving the needs of sustainable energy access for all.

Keywords Energy • Energy access • Energy security • Renewable energy • Environmental goods and services • World Trade Organization • Energy charter treaty

1 Introduction

Energy is central to every aspect of human life and activity, from lighting, heating and cooking to the functioning of all economic sectors. Still, about 2.9 billion people do not have access to modern energy services and over 1.1 billion have no access to electricity.[1] The majority of those people live in the developing and least developed countries of Asia and sub-Saharan Africa. This fact not only hampers economic development and poverty eradication but also results in premature deaths from using high-polluting solid fuels inside living quarters.[2]

[1] Se4all (2015).

[2] IPCC (2014), pp. 708–709.

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_12

The challenge of energy access has been recognised by the international community. Access to affordable, reliable, sustainable and modern energy for all is listed as the seventh Sustainable Development Goal (SDG 7) on the 2030 Agenda for Sustainable Development of the United Nations.[3] The accent on sustainability of energy access is not incidental. The reliance on cheap and easily accessible fossil fuels (coal, oil and natural gas) accounts for two thirds of global GHG emissions.[4] In order to break this negative energy-climate change nexus, one of the targets within SDG 7 is to increase substantially the share of renewable energy (RE) in the global energy mix.[5] The expansion of RE will also help to address the issue of imminent depletion of fossil fuels against the forecasts of increasing energy demand, and also the concerns about security of energy supply in light of the dependency of many countries on fossil fuel imports from states with unstable political regimes.[6]

The process of delivering sustainable energy access for all people requires steering by state policies and regulations. There is a need for regulatory support of investments in various segments of the energy sector, be it the expansion of energy infrastructure (electricity networks, pipelines, liquefied gas terminals etc.)[7] or the development of off-grid renewable energy projects.[8] Appropriate regulation is equally important for energy trade, which, through various trade instruments, could strengthen competitive positions of renewable energy *vis-a-vis* fossil fuels and enable supply of electricity generated from RE from long distances and across borders.

The current state of energy regulation is however not conducive to the ambitious goal of universal sustainable energy access. Most existing legal frameworks applicable to energy trade and investment lack mechanisms to promote liberalization of national energy sectors, enhance competition on energy markets and enable access to energy infrastructure and accommodation of RE. Filling these gaps in energy regulation should be a priority and a major challenge of global energy governance.[9]

This chapter examines the patchwork of regulatory responses in the field of trade and investment to the current energy challenges and reflects on the recent developments in relevant international fora in terms of their ability to take the regulatory framework for energy a step further in serving the needs of sustainable energy access for all. Section 2 discusses the importance of an appropriate regulatory environment for attracting investment and facilitating cross-border trade in the

[3]See SDG 7 in United Nations General Assembly (UNGA) Resolution A/RES/70/ '*Transforming Our World*: *The 2030 Sustainable Development Agenda*', adopted on 25 September 2015.

[4]IEA (2013), p 15.

[5]UNGA Res A/RES/70/1 of 25 September 2015 'Transforming Our World: The 2030 Sustainable Development Agenda'.

[6]This is particularly true for the EU. See EU (2015).

[7]Gudas (2015).

[8]Schmidt et al. (2013).

[9]See e.g. Leal-Arcas et al. (2014), pp. 82–85.

energy sector. Section 3 examines the international rules applicable to energy trade and investment and identifies gaps in the international regulatory framework. Section 4 presents some of the recent developments in international fora having the potential to contribute to the improvement of energy governance. Section 5 offers concluding remarks.

2 The Role of Regulation in Addressing Contemporary Energy Challenges

The problems the energy sector faces today are multiple and complex. However, three main challenges are beyond dispute – energy access for all, transition to RE and security of energy supply. Coping with these challenges would contribute to global energy security and create synergies with the strategies of economic growth and poverty reduction. The transition from fossil fuels to RE would not only enhance energy security but would also support climate change mitigation. Meeting these challenges, however, requires unprecedented levels of investment. According to some estimates, achieving universal sustainable energy access by the year 2030 would require total investment of nearly $1 trillion, or an average of $49 billion per year.[10] Besides the construction of energy infrastructure for the realization of existing export potential of oil and natural gas,[11] investments are needed for the development of large RE projects. Of vital importance is the construction of regional interconnections, or cross-border electricity networks, which would enable flows of electricity generated from hydro, solar and other RE sources over long distances.[12]

Attracting investment requires a proper regulatory environment, including high standards for investment protection, effective tax and competition laws and open trade policies.[13] This is particularly true for the energy sector, where investments are usually associated with higher risks than in other sectors due to their high capital intensity, relative illiquidity and long periods of amortization. Thus, only well-designed regulatory frameworks that provide legal guarantees and incentives to investors, as well as non-discriminatory conditions for trade in energy and energy equipment are relevant for creating cost-effective energy systems.

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[10]IEA (2012), p. 538.

[11]For instance, the current problem of energy security in Europe requires huge investments in redesigning natural gas infrastructure and constructing export and import liquefied natural gas (LNG) terminals. See Espa and Holzer (2015), pp. 372–374.

[12]The need for construction of cross-border transmission lines is particularly urgent in sub-Saharan Africa in light of the development of large-scale hydropower projects in the Democratic Republic of Congo, Cameroon, Ethiopia, Kenya and Mozambique carrying great potential for electricity supply in the whole region of Central and Eastern Africa. See IEA (2014), p. 14.

[13]OECD (2015), p. 23 ff.

The experience of the EU, which has made a remarkable progress in creating a regional energy market,[14] shows that an enabling regulatory framework for energy should include structural reforms and liberalization of the energy market. At the core of these reforms is the requirement of a third party access (TPA) and unbundling of energy life-cycle activities.[15] Unbundling, which means putting generation and transmission in separate legal entities or even in separate legal entities with different ownership has proven to be advantageous for the development of energy transmission systems, since vertical integration of the transmission system operator (TSO) with incumbent generators tends to distort the incentive to invest in new transmission lines.[16] Third party access is also important for attracting investments in energy infrastructure, since it allows private investors to participate in project funding and gain revenues. While the structure of the electricity market has undergone liberalization in the EU and other developed countries,[17] the situation in many developing countries remains largely unchanged. The construction and operation of transmission links in these countries are run by state monopolies.

In addition, the EU uses regulatory incentives in order to achieve higher rates of internal electricity market interconnection. Some of these regulatory incentives address the duration of licensing procedures, others provide exemptions from some EU internal market rules, including third party access.[18] Another category of regulatory incentives is related to access to the EU funding.[19] EU legislation also requires national regulatory authorities to set tariffs for the use of energy infrastructure at levels 'consistent with financing needs and the appropriate cost allocation for cross-border investments'.[20] Setting efficient transmission tariffs serves as a transmission price incentive and thereby stimulates investment in energy infrastructure.[21]

Proper regulation is also instrumental for the effective implementation of the off-grid energy access delivery model. Stand-alone RE based systems, such as solar panels for households, do not require power grids and can provide energy access in locations without access to energy grids in developing countries. The most salient

[14]In 'A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy', adopted by the EU Commission on 25 February 2015, free flow of energy across borders is viewed as a fifth freedom of the EU, along with the free movement of goods, services, persons and capital.

[15]Lowe et al. (2007), p. 24.

[16]Ibid.

[17]For example, third parties are allowed to invest in the electricity transmission lines and become eligible for regulated revenues in the EU, Australia and some US states (e.g. Hawaii), subject to certain conditions, such as the obligation to integrate renewable energy into the power production or the contribution to energy security. See Gudas (2015).

[18]EU Regulation 714/2009 on conditions for access to the network for cross-border exchanges in electricity.

[19]EU Regulation 1316/2013 establishing the Connecting Europe Facility, OJ L 348, 20.12.2013.

[20]EU Regulation 347/2013 on guidelines for trans-European energy infrastructure, 17.04.2013.

[21]Reith et al. (2012), p. 22.

regulatory issues of off-grid projects relate to the facilitation of technology transfer and deployment, lowering of investment risks and an energy subsidy reform aimed at the reduction of support for fossil fuels.[22]

As energy systems become increasingly interconnected, there is a tendency towards internationalization of energy laws,[23] not the least driven by contemporary energy challenges that transcend national borders and call for international cooperation.[24] The emerging global energy governance does not emanate from a single international institution. It relies on energy cooperation within different groups of countries and consists of policies and rules adopted at different fora, including various economic and environmental institutions.[25] The international regime for energy trade and investment is based on the international trade rules of the World Trade Organisation (WTO) and the investment protection provisions of the Energy Charter Treaty (ECT). The latter is the only international agreement, which specifically deals with energy.[26] It is also the only agreement that covers all or at least a significant part of the energy cycle – extraction and production (from an investment angle), and transportation (transit) and trade. With its specific focus on energy, the ECT could become a hub of global energy governance. Unfortunately, this potential has not been realized yet. The ECT experience shows that joined efforts in the field of energy by a multipolar, unequal and heterogeneous world community are bound to need a lot of time. For the time being, the international regime for trade and investment benefits from incremental steps made at different fora in support of the goals of energy security, climate change mitigation and energy access for the poor.

3 Gaps in International Legal Frameworks for Energy Trade and Investment

3.1 WTO Rules

International trade in energy is regulated by general rules for trade set out in the WTO Agreement. These rules fail to take into account the specific features of

[22]See e.g. Schmidt et al. (2013), pp. 90–91.

[23]Talus (2014), pp. 7–8.

[24]Cottier (2014), pp. 40–41.

[25]Institutions contributing to international energy cooperation and the development of global energy governance are as diverse as the Organization of the Petroleum Exporting Countries (OPEC), the International Atomic Energy Agency (IAEA), the International Energy Agency (IEA), International Renewable Energy Agency (IRENA), the World Trade Organization, the Energy Charter Treaty (ECT) and the United Nations Framework Convention on Climate Change (UNFCCC). See Leal-Arcas et al. (2014), pp. 24–25.

[26]Signed in 1994 and entered into force in 1998, the ECT unites energy-producing, energy-consuming and energy-transiting states from all over the world, with some of them having an observer status.

energy, which makes it different to other products. Energy, and particularly electricity, is 'special' when it comes to its physical characteristics, storage and transportation.[27] First, electrical power is intangible. Second, it requires simultaneous production and consumption, or additional technological processes for its storage.[28] Third, energy trade relies on the availability of fixed installation necessary for energy transportation. In contrast to other networks (roads, railways, canals etc.), energy networks (pipelines and power grids) have very little room for excess capacity, as they are planned and financed based on a specific demand. Despite these peculiarities, WTO rules and in particular provisions of the General Agreement on Tariffs and Trade (GATT) apply to trade in energy much in the same way as they apply to any other products. WTO members have to observe the non-discrimination principles of the most-favoured nation (MFN) and national treatment (NT) in the application of import duties,[29] internal taxes and regulations on energy products, and they may not use quantitative restrictions on energy imports and exports. However, while focusing on the reduction and elimination of market access restrictions, WTO rules are poorly designed to address the practice of export taxes widespread in energy trade, not to mention the inability to capture oil production quotas used by the Organisation of the Petroleum Exporting Countries (OPEC).[30] At the same time, some measures necessary for maintaining stability of interconnected electricity systems, such as power flow control, congestion and shortage avoidance measures, come into contradiction with the WTO prohibition of quantitative restrictions.

Special difficulties arise from the lack of clarity regarding the status of electricity under WTO law. While electricity is listed in the goods' schedules of concessions of WTO members and has already been treated as such in WTO disputes,[31] it seems possible to consider electricity as a process, where electricity in generation would be treated as a good, while electricity in transmission would be treated as a service.[32] In the latter case, rules of the General Agreement on Trade in Services (GATS) would apply. Energy services, however, are not listed as separate categories in the services schedules of WTO members, because they have long been perceived as accompanying elements of energy goods. The absence of energy services on the WTO's Services Sectoral Classification List (W/120) adds difficulties to the current negotiations on liberalization of trade in environmental goods and services (EGS), including those related to RE energy equipment.

[27]Marceau (2012), pp. 385–389. See also Howse (2009), p. 3.

[28]Luo Xing et al. (2015), pp. 513 ff.

[29]Some WTO members have also made tariff concessions for energy commodities, including electricity (HS 2716).

[30]While quantitative restrictions on trade is prohibited under Art. XI GATT, it is difficult to extend this prohibition to OPEC quotas concerning goods (oil) at the extraction (production) stage.

[31]See e.g. Appellate Body Report, *Canada-Renewable Energy*, WT/DS412/AB/R, adopted on 24 May 2013.

[32]See e.g. Howse (2009), p. 15.

An additional layer of complexity is due to the question of whether a regulatory differentiation in treatment of electricity generated from fossil fuels and RE sources ('grey' vs 'green' electricity) is compatible with WTO law. This has never been clarified by WTO adjudicative bodies. While it is not possible to distinguish 'green' and 'grey' electricity based on the physical properties once electricity has been fed in the transmission networks, tax exemptions for green electricity could be implemented through the certificates of origin of electricity. Whether such a scheme could pass the non-discrimination test under WTO rules or whether it would need justification under the environmental exceptions of Article XX GATT remains an open question.[33] In the latter case, space for regulatory manoeuvre would be limited, given the strictness of the conditions, under which justification of a measure could be accepted, as set out in the Chapeau of Article XX.

Legal uncertainty also exists with respect to the use of feed-in-tariffs (FIT) and other support schemes for renewable energy. The rules of the WTO's Agreement on Subsidies and Countervailing Measures (ASCM) may put them in the category of actionable subsidies, against which other WTO members could bring a complaint in the WTO dispute settlement or use countervailing duties (CVD). Moreover, in the Canada-Renewable Energy dispute, the AB ruled that the use of local content requirements in combination with a FIT scheme for solar and wind energy producers in the province of Ontario was not allowed.[34] Local content requirements are also the reason why India has recently lost a dispute with the US over its support program for solar energy.[35] The strict rules on the use of subsidies for renewable energy raise concerns about the lack of possibility for developing countries to develop their own RE production.[36]

By contrast, fossil fuel subsidies are hardly captured by WTO rules. Fossil fuel subsidies, such as dual prices for exports and internal consumption, apply across the board to all industries and companies, and thus they are neither considered to be export or import substitution-related (and hence not prohibited) nor specific (and hence not actionable). Thus, WTO rules are unable to constrain the use of fossil fuel subsidies, which, in case of their elimination, could provide up to half of the GHG emission reductions necessary to effectively combat climate change.[37]

Finally, WTO rules fail to meet the challenges pertinent to the use of energy infrastructure, especially those related to energy transit and third party access. Article V of the GATT, which provides freedom of transit[38] and regulates the

[33]Holzer et al. (2016).

[34]Appellate Body Report, *Canada-Renewable Energy*, WT/DS412/AB/R, adopted on 24 May 2013.

[35]Panel Report, *India —Solar Cells*, WT/DS456/R, circulated on 24 February 2016.

[36]Pierson (2015).

[37]Meyer (2013).

[38]Under Art. V:2 GATT, '(t)here shall be freedom of transit through the territory of each contracting party, via the routes most convenient for international transit, for traffic in transit to or from the territory of other contracting parties. No distinction shall be made which is based on the

imposition of transit charges, also applies to transit of gas through pipelines and electricity through power networks.[39] In addition, some recently acceded WTO members, particularly Ukraine, have undertaken freedom of transit obligation also with respect to energy in their WTO accession protocols. Yet, no disputes related to energy transit have ever been decided in the WTO, and there is lack of clarity about the application of the Article V provisions to transit of energy. The new WTO's Trade Facilitation Agreement (TFA), signed in 2013, has not advanced the law of Article V GATT as expected, despite this question being put forward by several actors in the past, including the EU and Switzerland.[40] It is unclear, for example, whether freedom of transit would bind private owners of energy infrastructure, as the WTO Agreement creates obligations for states only. Furthermore, there are no explicit provisions in the current WTO framework obliging member states to develop energy infrastructure for the benefit of other member states, nor is there a guarantee of competition and private investors access to energy infrastructure.[41] In sum, WTO rules do not regulate the establishment of capacity for energy transportation and thus have no impact on the expansion of electricity networks enabling long-distance cross-border electricity trade in RE and increasing of reliability and cost-effectiveness of energy supply.

3.2 Rules of the Energy Charter Treaty

The Energy Charter Treaty (ECT) specifically deals with trade and investment in the energy sector.[42] It combines legally binding ('hard') obligations – in particular with regard to investment protection, trade and transit provisions – with content that may be described as 'soft law', such as the provisions on energy efficiency and on issues as diverse as environmental protection, competition, technology transfer and access to capital.[43]

The importance of the ECT for attracting investment in the energy sector stems from its investment protection provisions. They cover both direct and portfolio

flag of vessels, the place of origin, departure, entry, exit or destination, or on any circumstances relating to the ownership of goods, of vessels or of other means of transport'.

[39]See e.g. Yanovich (2011), pp. 26–27; Cossy (2010), p. 115.

[40]TFA contains no energy-specific provisions.

[41]See e.g. Ehring and Selivanova (2011), p. 81, concluding that 'the issue of construction of new transit capacity is not tackled by the GATT 1994'.

[42]Under Articles 2 and 3, contracting parties undertake to promote long-term cooperation in the energy field and develop an open and competitive market for energy materials and products.

[43]For instance, the Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA) reinforces the commitment to undertake a good faith effort to minimize harmful environmental impacts resulting from the energy cycle. It promotes the use of market-based instruments, aiming at internalizing the full costs of the energy cycle into relevant pricing decisions. PEEREA requires its signatories to develop energy efficiency strategies and follow up on the implementation.

investments associated with a wide range of economic activities in the energy sector, such as energy exploration, extraction, refining, production, transmission, distribution and trade.[44] However, no legally binding commitments exist vis-à-vis the non-discriminatory treatment of investments at the pre-investment stage.[45] As the ECT proclaims the principle of sovereignty over energy resources, its parties are free to choose the ownership and structure of their energy sector, including whether to grant access to foreign investors or not.[46] Consequently, the ECT's legally binding non-discrimination commitments only apply to already established investments (the post-investment stage). Importantly, this commitment also extends to state-owned enterprises (state energy monopolies).

With regard to post-establishment conditions, contracting parties commit to comprehensive non-discrimination (e.g. MFN, NT). Pursuant to paragraph 1 of Article 10, investors are ensured of stable, equitable, favourable and transparent conditions, including fair and equitable treatment. Investors "shall also enjoy the most constant protection and security" and not be impaired in their management, maintenance, use, enjoyment or disposal by "unreasonable or discriminatory measures". The ECT also obliges contracting parties to observe any obligations they have entered into with an investor or an investment of an investor of any other contracting party. Expropriation is only permitted under narrowly circumscribed conditions: it needs to be in the public interest, non-discriminatory and carried out under due process of law; compensation shall be prompt, adequate and effective (Art. 13). The ECT parties are also obliged to guarantee the free transfer on investment funds (Art. 14).

The ECT's investment provisions under Articles 10–17 generally draw on the consolidated state of play with regard to bilateral investment treaties (BITs). In doing so, they reflect the sometimes contradictory interests of ECT contracting parties that include some very energy-dependent and some very energy-rich states. Whereas the ECT confirms the freedom of each contracting party to decide whether and to what extent energy resources will be developed, and whether and to what extent the energy sector will be opened to foreign investments, rules on the exploration, development and acquisition of resources must be publicly available, non-discriminatory and transparent.

The investor-state dispute settlement (ISDS), provided under Article 26, gives teeth to substantive investment protection provisions. An investor in the energy sector can initiate a dispute settlement procedure against a host state. In cases of nationalization or expropriation and impairment of investment management, maintenance, use, enjoyment and disposal by unreasonable or discriminatory measures,

[44] ECT Art. 1(5) and (6).

[45] This pre-authorization stage was meant to be covered by a follow-up Supplementary Treaty. See Selivanova (2011), p. 383.

[46] This also includes the right to selectively earmark only certain parts of its territory for exploration and development of its energy resources, determine the conditions pursuant to which exploration and exploitation are permitted, and set the environmental and safety standards as energy producing countries deem acceptable. See Art. 18 ECT.

investors can bring complaints to the domestic courts of the host state, ICSID (if both host state and home state are parties to the ICSID Convention) or international arbitration under the UNCITRAL or Stockholm Chamber of Commerce arbitration rules.[47] About 90 cases have been brought by investors under Art. 26 of the ECT so far, of which probably one of the most famous is the Yukos case, administered under the UNCITRAL arbitrations rules by the Permanent Court of Arbitration in the Hague. In that case, the Russian oil and gas company Yukos was awarded 50 billion USD (the largest arbitration award in history) in compensation for the expropriation of the company's assets by the Russian state.[48] More recently, the ISDS under the ECT has also showed to be able to balance the interests of investors and states in matters concerning the efficiency of support schemes for renewable energy. In the case brought by the Dutch company Charanne B.V. and Luxembourg's Construction Investments S.A.R.L. against Spain, Spain's Supreme Tribunal rejected the investors' claim, which called for compensation for cuts made to a feed-in tariff for solar energy.[49]

Trade-related provisions of the ECT cover the full range of energy materials and products, as well as energy-related equipment consisting of more than 70 categories of items, such as pipelines, turbines, nuclear reactors, power masts, platforms, transformers and pumps.[50] The ECT regime for energy trade is based on the WTO rules for trade in goods but extends the GATT's reach to those ECT contracting parties that are not members of the WTO.[51] The main addressee of this 'WTO by reference' approach of Article 4 used to be the Russian Federation, which has in the meantime not only joined the WTO but has also stopped the (provisional) application of the ECT. However, the ECT goes beyond WTO rules in the issues of energy transit.

Article 7 ECT, which also applies to high-voltage electricity transmission grids and lines, contains generally all freedom of transit and non-discrimination rules found in Article V GATT. But in addition to the requirement to take 'necessary measures' to facilitate the transit of energy, paragraph 2 of the article stipulates that ECT contracting parties "shall encourage relevant entities to co-operate in ... (b) the development and operation of Energy Transport Facilities serving the Areas of more than one Contracting Party; (d) facilitating the interconnection of Energy Transport Facilities". Paragraph 4 further requires that "(i)n the event that Transit of Energy Materials and Products cannot be achieved on commercial terms by means of Energy Transport Facilities the Contracting Parties shall not place

[47] ECT Art. 26 (2). See also Ruff et al. (2014).

[48] PCA Case No. AA 227, final award of 18 July 2014.

[49] Spain's Supreme Tribunal case no. 062/2012, with award rendered on 21.01.2016.

[50] See Trade Amendment of 1998, Annex EQ I.

[51] It should be noted that in those cases, where a dispute over energy trade matters arises between ECT contracting parties, of which at least one is a non-WTO member, the ECT provides for its own state-to-state dispute settlement. However, if all parties to a dispute are WTO members, such a dispute must be resolved at the WTO. See Selivanova (2011), p. 379.

obstacles in the way of new capacity being established". Thus, the right to transit under the ECT is more effective than under the GATT, arguably allowing for the interpretation that governments will have little excuse not to authorize and support the construction of new energy transport facilities if investors are willing to pay for the construction and if, as provided in paragraph 5(a), this construction does not endanger the security or efficiency of transit country's energy systems.[52] Nevertheless, the problem to make the freedom of transit obligation under the ECT a fully effective right lies in the relative discretion of the state to decide if the construction of transit facilities could present the risk for its security or efficiency of its energy system.[53] Moreover, according to paragraph 9 of Article 7, ECT contracting parties have discretion regarding the type of energy transport facilities they want to allow for the construction in their territory.

The ECT does not require mandatory third party access, which is a highly sensitive topic for countries with monopolized energy sector structures.[54] In this respect, it is worth recalling that the ECT explicitly affirms that state contracting parties enjoy full sovereignty over energy resources. While this may be a truism as a matter of principle,[55] this theme plays out prominently in the debate about the promotion of competition in the energy sector. Another drawback of the ECT energy transit regime is that although paragraph 7 of Article 7 provides for conciliation of disputes arising out of transit, it is limited to disputes over already launched transit and does not cover cases of refusal of granting transit.[56] Moreover, this possibility has never been used by states and proved to be of little help at the times of the Russia-Ukraine conflicts over gas supplies.

More effective and specific rules applicable to transit could have been provided by the Energy Transit Protocol – a treaty, which was negotiated among ECT parties but which has never been adopted.[57] It would introduce rules which would 'facilitate the construction, expansion, extension, reconstruction, and operation of Energy

[52]Ehring and Selivanova (2011), pp. 84–86.

[53]Ibid.

[54]Wälde and Gunst (2002), pp. 209–211. It should be mentioned that to some extent the absence of the TPA obligation is mitigated by non-discrimination rules imposed on state owned energy enterprises (energy monopolies). Pursuant to Art. 22, ECT parties may not encourage or require their state enterprises to engage in practices inconsistent with any other ECT obligation of that contracting party, such as encouraging or requiring to charge a higher transit fee to foreign pipeline users. Moreover, ECT parties have to ensure that their state enterprises respect the investment-related Treaty provisions when they sell or otherwise provide goods and services. State enterprises are obliged, for instance, to supply natural gas or electricity to foreign investors at prices no higher than those charged to domestic companies.

[55]Cf. UNGA Res 626 (VII) of 21 December 1952 ('*sovereignty of any state over its natural resources*') *and* the famous UNGA Res 1803 (XVII) of 14 December 1962 on 'Permanent sovereignty over natural resources' pursuant to which the 'right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned.'

[56]Selivanova (2011).

[57]Negotiations ended in 2011 without signing.

Transport Facilities used for Transit'.[58] The draft Energy Transit Protocol contains an obligation of a contracting party to ensure a transparent and non-discriminatory procedure for the authorization of the construction of energy transport facilities.[59] Had it been adopted, this agreement would have provided a more effective and practical system of rights and obligations of states and private investors with respect to the establishment of new energy transit facilities, including electricity transmission lines. Currently, these rights and obligations remain mere intentions.

4 Recent Developments in International Negotiations on Energy

The awareness about the urgency of solutions to energy security and climate change, which has increased in recent years due to the changes in geopolitical situation and the breakthrough in climate negotiations, has given a new impetus to negotiations on energy in international fora. The most notable developments concern liberalization of trade in green energy and energy equipment and the expansion of the geographical scope of participants. In addition, energy has become a central topic of regional trade negotiations. While not being able to solve all the existing regulatory problems of energy governance, these developments can be seen as important building stones in the international regime on energy trade and investment.

4.1 Negotiations of the Environmental Goods Agreement

A recent development in the WTO with potentially high relevance for energy has been the launch of the negotiations of the Environmental Goods Agreement (EGA) aimed at the elimination or at least a significant reduction of tariffs on products contributing for achieving environmental protection goals. These negotiations build upon the preceding negotiations on liberalization of trade and investment in environmental goods (EG) at the regional forum for Asia-Pacific Economic Cooperation (APEC).[60] In 2011–2012, APEC countries committed themselves to the reduction of applied tariff rates on EG to 5 % by the end of 2015 or less and adopted a list of EG on which the tariffs would be reduced.[61] Two years later, at the World

[58] Art. 2 of draft Energy Transit Protocol. See Ehring and Selivanova (2011), p. 96, fn. 162.

[59] Furthermore, various safeguards are foreseen to prevent the interruption of transit.

[60] APEC consists of 21 countries of the Pacific Rim including the US, China, Japan, Australia and Russia.

[61] See Annex C 'APEC List of Environmental Goods' of the 2012 APEC Leaders' Declaration signed on 8–9 Sept. 2012 in Vladivostok. This initiative of APEC countries has been without prejudice to their positions in the WTO.

Economic Forum in Davos, some of those APEC countries (Australia, Canada, China, Taiwan, Hong Kong, Japan, Korea, New Zealand, Singapore and the US) were joined by some non-APEC countries (Costa Rica, the EU, Norway, Switzerland and Iceland) and together they initiated negotiations of the EGA within the WTO.[62]

Negotiations of such an agreement within the WTO is in line with the WTO's Doha Development Agenda (DDA) adopted in 2001, which, among other tasks, mandates WTO members to start negotiations on "the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services".[63] EGA negotiations are based on the 'critical mass' principle: the agreement would enter into force once countries representing a critical mass in EG trade, agreed to the deal. Of course, benefits of increased market access resulted from the elimination/reduction of tariffs would be shared with all WTO members pursuant to Article I GATT. The number of participants in EGA negotiations (currently 17 countries) is close to reaching a critical mass in EG (about 90 % of pertinent trade).[64]

The negotiations over liberalization of trade in EG under the new agenda of EGA are currently stalled due to disagreement among negotiating parties over the content of the EG list.[65] The draft agreed list contains 350 tariff lines and ex outs, i.e. products, which are not captured by tariff codes under the Harmonised System (HS).[66] The products included relate to such areas as clean energy, energy efficiency, air pollution control, environmental monitoring and analysis etc.[67] Some countries (e.g. China) also object to the immediate elimination of tariffs, preferring reductions to complete elimination.

The EGA negotiations use the APEC list of 54 EG as starting point. Some of the products listed are crucial for RE, such as solar panels, and gas and wind turbines. Yet, tariffs on these products are already low, as they are covered by the WTO's

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[62]See Joint Statement Regarding Trade in Environmental Goods, 24 January 2014 at Davos, Switzerland. The negotiations were later joined by Israel and Turkey, so that currently the total number of negotiating countries is 17.

[63]Para 31 (iii) DDA.

[64]What constitutes the critical mass is nowhere defined, but it is usually understood to constitute 90 % of all trade volumes in the negotiated area of trade. See Goff (2015).

[65]See 'Environmental goods agreement trade talks stall ahead of Nairobi ministerial', *Bridges*, 9 December 2015. There has also been a debate in the WTO on what constitutes an environmental good and an environmental service. The questions that have been asked include: How to account for dual use of products? Should goods produced using "cleaner" processes be considered environmental? How to catch up with rapid technological changes that require corrections in the list based on HS for goods or W/120 for services classification? For more on this, see Cottier and Baracol (2009).

[66]The HS of the World Customs Organisation serves as the basis for schedules of tariff concessions of WTO members. See Appellate Body Report, *EC-Chicken Cuts*, WT/DS269/AB/R, adopted on 27 September 2005, para. 199.

[67]Ibid.

Information Technology Agreement (ITA), to which all 17 negotiating countries are parties.[68] Thus, the effects of tariff reduction (should countries not agree on complete elimination of tariffs) would be small, unless the EGA would lead to the full elimination of tariffs. However, tariffs on energy-related products which are not covered by the ITA may constitute up to 35 %.[69] An important step in liberalization of EG trade would also be an exemption of EG from trade remedies. Antidumping and countervailing duties are actively used by the US against imports of solar panels and wind turbines from China, significantly raising their price in the US market. China does the same in response, turning the wheel of 'solar and wind wars'.[70] Unfortunately, the use (or non-use) of trade remedies is not part of EGA negotiations.[71]

Nevertheless, the EGA is expected to be a first step towards a broader liberalization of trade related to green technologies. If concluded, this agreement might expand its scope in the future to additional EG, as technologies develop, and also to environmental services and non-tariff barriers.[72] The reduction of trade barriers to environmental goods and services (EGS) would make RE technologies cheaper and thereby support the competitiveness of RE in relation to fossil fuel energy and facilitate technology transfer to developing countries. Thus, a successful conclusion of the EGA would be an important piece in the global energy governance puzzle.

4.2 International Energy Charter

Despite increasing scepticism as to the ECT's ability to become the regulatory hub and the major point of reference for all matters related to the international regulation of energy trade and investment,[73] the Energy Charter might regain its appeal due to the expansion of its geographical scope, as negotiations centre for matters of high importance to developing countries. The interest of the Energy Charter to establish some distance to the EU, which was instrumental to its coming into existence, seems to concentrate its political capital on new endeavours such as the Energy Community. This coincides with the interests of China, India and other emerging economies, which are as energy-dependent (if not more so) as the EU or Japan and seem keen to have their supply interests secured. Suppliers of energy are

[68] ITA currently includes 81 WTO member countries.

[69] USTR (2015). One example is a tariff on energy-efficient lighting, which in India constitutes 30 % (and nontariff barrier to it is equivalent to 106 %). See Goff (2015), p. 6.

[70] Vermulst and Meng (2016).

[71] Goff, p. 6.

[72] USTR (2015).

[73] The role of ECT has been weakened by the Ukraine-Russian gas conflict and the subsequent retreat of Russia, as well as the lack of progress with regard to several envisaged side agreements, such as the one on transit, environmental aspects and technology.

also interested in a manageable forum, where their voice can be heard and translated into international law-making. Despite their wealth, energy suppliers are technologically challenged and, in addition, concerned about the consequences of climate change. They also share a significant degree of political volatility. Hence, an organization offering to develop multilateral and mutually beneficial and reciprocally advantageous energy negotiations may prove sufficiently attractive to allow the ECT's membership base to expand.

Against this background, the ECT contracting parties adopted the Consolidation, Expansion and Outreach (CONEXO) policy aimed at winning over countries that have yet to ratify the ECT. In particular, the ECT Secretariat seems to target more than 30 observer countries inclining them to accept full membership by threatening to abolish the quasi-permanent observer status. The CONEXO process is expected to lead to an updated treaty (Energy Charter 2.0) with an enlarged membership and an extended scope of covered issues. If successful, this process may turn the ECT into the centre of gravity of global energy governance. A first step towards such an outcome was made in June 2015 with the signing of a declaration on the International Energy Charter (IEC). Under the new declaration, countries from six continents agreed to create a climate favourable to the operation of enterprises and to the flow of investments and technologies in order to achieve the objectives of sustainable energy development.[74] In particular, they undertook to attempt joint or coordinated action in the fields of access to energy sources and energy markets, liberalisation of trade in energy, promotion and protection of investments in all energy sectors, technology transfer and dissemination, energy efficiency, environmental protection and sustainable and clean energy, as well as diversification of energy sources and routes. The IEC signatories also wish to facilitate the realization of infrastructural projects aiming to provide global and regional energy security. While the IEC is non-binding, the adherence by more than 70 countries with varying roles in the global energy chain and different levels of economic development strengthens international cooperation with regard to the goal of universal sustainable energy access. It may constitute a first step towards a legally binding outcome of the ECT's reform which would be an important development regarding global energy governance.

4.3 Transatlantic Negotiations on Energy

The issues of energy trade and investment are also dealt with in regional fora. Regional cooperation is especially important for the development of cross-border interconnectors and the enhancement of security of energy supplies. It is instrumental for the establishment of power pools, development of regional energy markets and integration of renewable energy sources. With various degrees of

[74] ECT (2015).

success, energy issues have also been addressed under regional trade agreements (RTAs).[75] Some RTAs contain provisions on energy trade and investment that go beyond WTO rules. The most remarkable in this respect is the North American Free Trade Agreement (NAFTA). Its Chap. 6 on Energy and Basic Petrochemicals prohibits dual pricing practices and the use of export duties in energy trade between the parties (Art. 603 and 604). However, the development of cross-border electricity network and access to energy infrastructure are not addressed by NAFTA energy provisions. In this respect, NAFTA Article 601 confirms full respect for the Constitutions of the parties, thus setting limits to the regulatory leverage of the FTA with respect to energy trade and investment in general and the establishment of energy infrastructure in particular.[76]

Building on existing regional cooperation, the EU and the US address energy trade and investment within the negotiations of the Transatlantic Trade and Investment Partnership (TTIP). Indeed, the TTIP may contain a separate chapter on energy.[77] The energy negotiations in TTIP are motivated not only by the lack of international disciplines on trade in energy and raw materials, but also by the challenges experienced by the EU in the field of energy security.[78] The conclusion of an agreement between the EU and the US may result in the liberalization of the US energy export regime. This would lead to lifting export restrictions for oil and gas and facilitating the supply of the liquefied shale gas from the US to Europe.[79] Other elements discussed include transit of electricity through transmission networks, including third-party access and regulatory control of an independent regulator, and cooperation in the area of renewable energy, including support of the relevant projects.[80] If the TTIP is concluded containing the envisaged energy provisions, it will have an impact on the development of international energy regulation. The TTIP rules on energy, particularly those related to the promotion of competition in the energy market and the expansion of the share of renewable energy in the energy mix, would influence the pertinent discussion and could serve as a model for multilateral rules on energy trade and investment.

[75]Cooperation in the energy sector is part of regional integration within the South African Development Community (SADC). To increase power accessibility and facilitate the integration of RE sources, nine member states of SADC have merged their electricity grids into the Southern African Power Pool (SAPP). Despite these efforts, the scale of electricity trade within SAPP remains small leading to continuing inefficiencies in the distribution of electricity in the region. See Uddin and Taplin (2015), p. 500.

[76]See Art. 18 ECT and Art. 601 NAFTA, respectively.

[77]EU (2013).

[78]Espa and Holzer (2015).

[79]Ibid.

[80]EU (2013).

5 Conclusion

International rules for energy trade and investment fail to address issues critical for achieving the sustainable development goal of clean energy access for all. They fall short to effectively support renewables in their competition with fossil fuels, enable green technology transfer and meet the needs of the energy sector of developing countries, primarily with regard to the delivery of energy access to the poor. They do not explicitly address the problem of energy security, which is currently dealt with by homogeneous sub-sets of the international community, indicating that the issue seems not yet ready for being addressed at a multilateral level.[81] Therefore, the recent developments in international energy-related forums, such as the negotiations of the Environmental Goods Agreement in the WTO, the declaration on the International Energy Charter and the energy negotiations under the Transatlantic Trade and Investment Partnership are welcome attempts to fill the gaps in the international framework for energy trade and investment.

International rules applicable to energy trade and investment are dispersed among several international agreements. Tackling the issues of energy trade and investment in one international agreement could bring more clarity and coherence in the international regulation of energy but it seems to require an amount of political capital that nobody is currently willing or able to spend. Anyone dealing with WTO law is reminiscent of past experiences with a special status for a 'special product' category. It took 50 years to bring agricultural products back into the realm of 'general' world trade law, despite ongoing significant differences as to how that 'general' law is applied to this product category. Efforts to classify cultural goods as *extra commercio* have, at the technical level, been largely unsuccessful: while there are very limited GATS commitments in both quantitative and qualitative terms, the creation of an a priori special regime has been rejected.[82] 'General' trade rules, as it has been shown in that case and is visible in the very diverging tariff rates with regard to goods, allow a very significant degree of differentiation, without creating special regimes.[83]

The creation of a truly global regulatory regime for energy is hampered by the political sensitivity of the subject. Sovereignty of states over energy resources limits the impact of international energy regulations on the organization of national energy sectors, including competition and participation of foreign investors. Divergent national norms regarding energy are the consequence. Other barriers to a

[81] Security of supply is addressed by the International Energy Agency (IEA), currently comprising of 29 developed countries. Under the IEA's Coordinated Emergency Response Mechanism, oil stocks of IEA member states are kept at the amount equivalent to at least 90 days of net oil imports. See Leal-Arcas et al. (2014), p. 43.

[82] Hahn, M (2006).

[83] Whereas the EU has internally subjected decisions on cultural goods to a different voting procedure (Art. 207 (4) TFEU), it has a priori excluded them from commitments in its free trade agreements.

single and comprehensive trade and investment regime for energy include differences in the interests of energy-exporting and energy-importing, as well as developed and developing countries. For instance, the goal of expansion of the share of RE needs to be balanced against the basic needs of electrification in some countries. Finally, special regulatory needs of certain types of energy cannot be dealt with under general conditions for energy trade and investment. This particularly applies to nuclear energy, which is regulated by separate international institutions, including the International Atomic Energy Agency (IAEA), due to nuclear safety and proliferation concerns.

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Chapter 13
Energy Charter Treaty: Standing Out Beside the WTO

Noriko Yodogawa

Abstract This chapter summarizes the relationship between the Energy Charter Treaty and provisions of the General Agreement on Tariffs and Trade. The Energy Charter Treaty enhances the provisions of the GATT and acts as a WTO Plus agreement.

Keywords Energy charter treaty • Investment in energy

1 Introduction

There seems to be no doubt that, in the modern world, no major state can maintain its economy without being involved in international trade. Thus, it is essential that fair rules for international trade are shared between states; indeed, such framework of rules is provided by the World Trade Organization (WTO).

However, it is also the fact that, the more states are involved in the rulemaking and the more fields are included in the scope of the rules, the more difficult it usually is to establish common rules. Therefore, it may sometimes make sense to limit the number of the states to be involved (as in the case of bilateral free trade agreements and in the Organisation for Economic Cooperation and Development), or narrow down the scope of the fields to which the rules should apply (as in the case of investment treaties). However, it should be noted that these solutions may cast doubt as to the raison-d'être of such rules in the event that there is another framework overlapping with or comprising such narrowed rules.

In this regard, the Energy Charter Treaty (ECT) is a notable example of a framework of legal rules applicable to a specific field (i.e., energy) shared by a limited, but relatively large, number of states. This chapter briefly examines the member composition and contents of the ECT, then identifies at which points those contents overlap with, and stand out from, the WTO rules. This chapter concludes by proposing the further steps to enhance the advantage of the ECT so that it can

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© Springer Japan 2016

M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_13

still remain relevant when the WTO continues to be the most fundamental framework for legal rules of international trade.

2 Profile of the ECT

2.1 History

After the Soviet Union was dissolved, there were a number of states who were concerned about how the trade in energy materials could be secured. With the end of the Cold War, there was an atmosphere for cooperation, and thus, states who had the same concern came together to establish a common background.[1] However, it was not an easy task to agree upon a set of legally binding rules, and therefore, those states adopted a political declaration without binding effect. This is the European Energy Charter (1991 Charter), signed in 1991.[2] The 1991 Charter explicitly stated that the signatories would negotiate towards the adoption of legally binding rules, and accordingly, the negotiation was concluded in the form of the ECT, first signed in 1994.[3] In 1998, the ECT entered into effect.[4]

2.2 Member Composition

2.2.1 Contracting Parties and Signatories

As of 20 February 2016, the ECT has 49 Contracting Parties (48 states, and the European Union (EU) and EUROATOM, collectively counted as one).[5] It should be noted here that the EU is separately a Contracting Party to the ECT beside its Member States. This means that the 28 EU Member States are included in the abovementioned 48, except for Italy, which has withdrawn from the ECT as of 1 January 2016.[6] In addition to these Contracting Parties who have not only signed but also ratified, and are legally bound by, the ECT, there are 4 signatories, namely,

[1] The Energy Charter website, "Process", Overview http://www.energycharter.org/process/overview/

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] The Energy Charter website, "Who We Are", Members and Observers http://www.energycharter.org/who-we-are/members-observers/

[6] Italy remains within the framework of the Energy Charter Process as an observer. The fact that the EU is a Contracting Party to the ECT while Italy is an observer thereof may raise some difficulties in identifying how the ECT applies to various circumstances.

Australia, Belarus, Norway and Russia, who have signed but not ratified the ECT (in particular, in 2009, Russia officially stated its intention not to ratify the ECT).[7]

2.2.2 Observers

It is sometimes the case that, for a state who is not a member of a framework of legally binding rules, it is too challenging to fully join all at once, even though such state is interested in that framework and its associated activities. The Energy Charter Conference (ECC), the inter-governmental organization established by the ECT to, *inter alia*, facilitate the implementation of the ECT's principles, is aware of this, and therefore, opens itself to those states by granting them the status of an observer.

Observers to the ECC may attend the meetings of the ECC and its subsidiary bodies, and receive the documents for and at such meetings; however, observers are not entitled to vote or join the consensus to adopt resolutions of the ECC and its subsidiary bodies.

2.2.3 Recent Movements

The ECC recognizes the importance of involving energy-rich states in the member circle of the ECT and its related activities (the so-called Energy Charter Process). Thus, the ECC's Secretariat (Energy Charter Secretariat (ECS)) is active in educating states who are not familiar with the Energy Charter Process and subsequently in inviting them to become observers. However, as described above, the 1991 Charter, which a state signs to become an observer, is a document established in 1991 and is sometimes criticized as being outdated or too Europe-oriented (as its title shows).

Under such circumstances, the ECC proposed an "updated" version of the 1991 Charter, namely, the International Energy Charter (2015 Charter). The 2015 Charter refers to some of the modern problems in the energy field that were not touched upon by the 1991 Charter (e.g., energy poverty and green economy), and looks proactively at the non-European territories. The 2015 Charter was adopted in May 2015 at a conference where more than 65 parties (states and organizations) signed it.[8] Subsequently, more states signed it, and as of 20 February 2016, there are 71 signatories of the 2015 Charter.[9] Among them, ten states and the Economic

[7]The Energy Charter website, "Who We Are", Members and Observers, Russian Federation http://www.energycharter.org/who-we-are/members-observers/countries/russian-federation/

[8]The Energy Charter website, "Process", Overview http://www.energycharter.org/process/overview/

[9]The Energy Charter website, "Process", International Energy Charter http://www.energycharter.org/process/international-energy-charter-2015/ Thisweb-page lists only 70 signatories (EU and EURATOM are collectively counted as one). However, in addition to those 70, Iran has signed the

Community of West African States were the truly new members of the Energy Charter Process, in the sense that they were not observers of the ECC before.

3 Contents of the ECT and Comparison to the WTO

The ECT applies to (i) trade and transit of the Energy Materials and Products, (ii) the investment protection in the energy sector, (iii) dispute resolution in relation to matters covered by the ECT, and (iv) the promotion of energy efficiency and the attempts to minimize the environmental impact of energy production and use.[10] This section briefly reviews each of these four pillars.

3.1 Trade and Transit

3.1.1 Trade

The ECT incorporates the GATT/WTO rules by obliging its Contracting Parties to comply with those rules.[11] Therefore, in terms of the contents of the rules, it must be admitted that the ECT does not add much novelty to the WTO regime. However, the important point here is that this GATT/WTO rule imposition by the ECT applies to some states who are the ECT Contracting Parties but are not the WTO members. In other words, the ECT "extends" the GATT/WTO rule application to non-WTO member states in the realm of the trade in Energy Materials and Products. Given that the ECT does not intervene in trade between the WTO members,[12] the manner of application of the trade rules under the ECT is categorized as follows:

A party to the trade / The other party to the trade	ECT contracting party and WTO member	ECT contracting party but not WTO member
ECT contracting party and WTO member	Only WTO agreements apply	GAATT/WTO rules incorporated into the ECT
ECT contracting party but not WTO member	GATT/WTO rules incorporated into the ECT	GATT/WTO rules incorporated into the ECT

2015 Charter. (The Energy Charter website, "What We Do", Events, First Group Signing Event of the International Energy Charter for new countries joining the Energy Charter Process http://www.energycharter.org/what-we-do/events/international-energy-charter-group-signing/)

[10]The Energy Charter website, "Process", Energy Charter Treaty http://www.energycharter.org/process/energy-charter-treaty-1994/energy-charter-treaty/

[11]Article 29(2) of the ECT; Amendment to the Trade-Related Provisions of the ECT.

[12]*Id.*

Among the ECT Contracting Parties and signatories, Azerbaijan, Belarus, Bosnia and Herzegovina, Turkmenistan and Uzbekistan are not WTO members as of 20 February 2016.[13] (Belarus has not ratified the ECT, but has been provisionally applying the ECT as a signatory.)[14]

3.1.2 Transit

For transit, it should be recalled that Article V of the GATT provides for freedom of transit. The ECT refers to this principle in Article 7(1), but does not end there. The ECT has more detailed provisions for the following aspects:

- While both the GATT and the ECT provide that there shall be no discrimination between transit from one state and transit from another state, the ECT further provides that, in terms of the use of Energy Transport Facilities, the ECT Contracting Parties shall treat the Energy Materials and Products in transit in no less favorable manner than the treatment accorded to those originated in or destined for their own territories[15]; and
- The ECT has dispute resolution procedures specifically designed for disputes relating to transit of Energy Materials and Products.[16]

The latter is notable in that these dispute resolution procedures oblige the disputing Contracting Parties to refrain from interrupting or reducing the existing flow of Energy Materials and Products in transit, prior to the conclusion of these procedures.[17] In other words, even when there is a dispute concerning transit of Energy Materials and Products, those materials and products continue to flow in the same manner as they would when there is no such dispute.

The following chart shows outline of the ECT's dispute resolution procedures for transit disputes[18]:

[13] The WTO's website, "WTO Membership", Members https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm

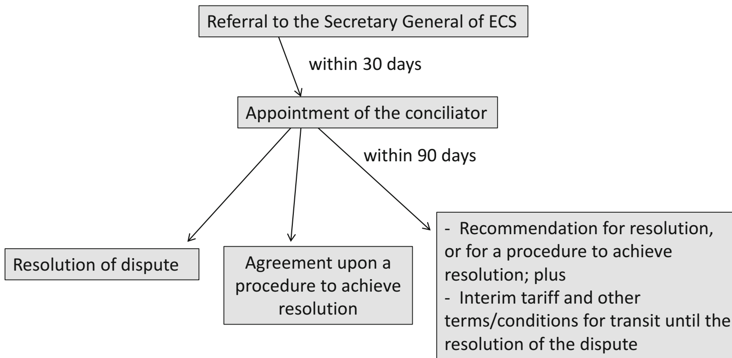
[14] The Energy Charter website, "Who We Are", Members and Observers, Belarus http://www.energycharter.org/who-we-are/members-observers/countries/belarus/

[15] Article 7(3) of the ECT.

[16] Article 7(7) of the ECT.

[17] Article 7(6) of the ECT.

[18] Article 7(7)(a) to (d) of the ECT.



As indicated above, the length of the procedures is quite short in comparison to typical arbitration proceedings or the procedures under the WTO Dispute Settlement Understanding. Combined with the above-mentioned prohibition of interruption and reduction of the existing flow of transited Energy Materials and Products, the ECT's transit dispute resolution mechanism could be highly effective; unfortunately, this has not been the case to date, and the problem will be discussed later in this chapter.

3.2 *Investment*

The ECT has a set of comprehensive investment protection provisions that are comparable to modern bilateral investment treaties, including, *inter alia*, a broad definition of investment,[19] a fair and equitable treatment provision,[20] national treatment and most favored nation treatment provisions,[21] a so-called umbrella clause (i.e., a provision under which the host state is legally bound, as an obligation under the investment treaty, to perform the contractual obligations imposed on such state under a contract with an investor)[22] and a set of investor-sate arbitration provisions.[23]

It should be noted that, while the ECT's trade provisions apply only to the trade of Energy Materials and Products and, where applicable, Energy-Related Equipment (i.e., trade in goods), its investment protection provisions cover investments made in services in the energy sector. This becomes clearer when compared to the WTO's Agreement on Trade Related Investment Measures (TRIMs Agreement). Article 1 of the TRIMs Agreement provides that "[the said] Agreement applies to investment measures related to trade in goods only", while the ECT's investment

[19] Article 1(6) of the ECT.
[20] Article 10(1) of the ECT.
[21] Article 10(7) of the ECT.
[22] Article 10(1) of the ECT.
[23] Article 26 of the ECT.

protection provisions apply to "any Investment associated with an Economic Activity in the Energy Sector".[24]

The foregoing shows that the ECT protects investments in the energy sector thoroughly, and in particular, more fully than the WTO does. It should be emphasized that these protection rules are shared by approximately 50 states, rather than two states as in bilateral investment treaties or three states as in the North American Free Trade Agreement.

3.3 Dispute Resolution

Apart from the specific dispute resolution provisions for disputes relating to transit, and the investor-state arbitration provisions, the ECT has two more sets of dispute resolution provisions, namely, those for trade disputes,[25] and the general state-to-state dispute resolution provisions.[26]

The trade dispute resolution provisions are in line with the WTO's Dispute Settlement Understanding, but are slightly simplified. For instance, under the ECT, the panelists shall always be chosen from the pre-existing roster,[27] and there is no Appellate Body (accordingly, the panel is the venue for the final resolution of trade disputes under the ECT).[28] These simplifications are made because, just like the substantive provisions for trade, the ECT's trade dispute resolution provisions apply to disputes relating to trade involving, at least, one state who is not a WTO member.[29] Thus, the ECT addresses the concern that, when its trade dispute resolution provisions come into play, at least one of the disputing Contracting Parties is a state that is not ready to abide by the WTO's detailed and lengthy dispute settlement mechanism.

3.4 Energy Efficiency and Environmental Aspects

The ECT is accompanied by a protocol, entitled as the Protocol on Energy Efficiency and Related Environmental Aspects (PEEREA). Unlike the main body of the ECT, the provisions in the PEEREA are of an endeavor-based nature.[30] Each Contracting Party shall establish energy efficiency policies, as well as legal and

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[24] Article 1(6) of the ECT.

[25] Article 29(7) of, and Annex D to, the ECT.

[26] Article 27 of the ECT.

[27] Clause (2)(d) of Annex D to the ECT.

[28] *See* Annex D to the ECT.

[29] Article 29(7) of the ECT.

[30] *See* Article 19(1) of the ECT.

regulatory frameworks, to enhance, *inter alia*, the mechanisms for financing energy efficiency initiatives and the transparency in legal and regulatory frameworks.[31] The obligation to establish these policies and frameworks is solid; however, there is no monitoring mechanism, and in this sense, the implementation of the PEEREA is based on the Contracting Parties' endeavors. In addition to this call for establishing unilateral policies and frameworks, the ECT provides for mutual cooperation and coordination between the Contracting Parties.[32]

4 How the ECT Can Remain Important Beside the WTO

As the foregoing shows, it is certainly clear that the contents of the ECT are to some extent overlapping with those of the WTO Agreements. Therefore, in order for the ECT to remain meaningful despite such overlaps, it is necessary to enhance the factors for which the ECT has a system more advanced than the WTO Agreements.

As explained above, the ECT's advanced nature is most notable in two points: the relatively large number of states who share the common rules for investment protection, and the dispute resolution procedures specifically designed for disputes concerning a transit of Energy Materials and Products. In neither of these areas is the ECT's mechanism complete, which leaves room for such improvements as proposed below.

4.1 Investment Protection

It may be said, not only for the ECT, but also in general for any investment treaty, that the effectiveness of the protection of investments and investors becomes more evident when there is an award in an arbitration for a dispute between an investor and the host state, as that is the moment when an investor ultimately and definitively knows to what treatment it is actually entitled from the host state. In this context, it would be important and useful for an investor (or a potential investor) to keep track of the record of awards rendered under the investment treaty applicable to its investment, with a view to obtaining guidance as to what protection should be granted to its own investment.

However, such tracking is difficult under the ECT because there is no obligation for the disputing parties to notify the ECS of the fact that they are in arbitration.[33] The ECS has been compiling the information of ECT-based investor-state arbitration cases and posts it on its website. As of 20 February 2016, nearly 90 cases are

[31] Articles 3(2) and 5 of the PEEREA.

[32] Article 19(1)(c) and (g) of the ECT.

[33] *See* Article 26 of the ECT.

recorded there.[34] This compilation is made by the ECS regularly checking the website of the International Centre for Settlement of Investment Disputes (ICSID) and sending requests to lawyers and states' delegations to share the information. The former must be reliable because the ICSID systematically uploads the basic information of all the cases submitted to the ICSID,[35] but this cannot be comprehensive because the ECT allows the disputing parties to submit their dispute to either of two other fora, namely, arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law, and under the Arbitration Institute of the Stockholm Chamber of Commerce.[36] These two fora do not have such a system of compiling and disclosing information as the ICSID, which is why the ECS needs to send inquiries to states and lawyers.

Although the disputing parties' wish to maintain confidentiality of the cases should be respected, this might be achieved by avoiding the disclosure of detailed information. Considering that the host state's policies and actions are analyzed in investor-state arbitration cases, it could be said that these cases are to some extent inherently of a public nature. This would lead to an argument for at least disclosure of the fact that the case exists, as well as the information of which provisions of the ECT are at issue. Accordingly, it would be worthwhile to consider obliging the Contracting Parties to notify to the ECS when an investor submits a dispute against them to arbitration under the ECT. It would be difficult to amend the ECT to incorporate such obligation, but the foregoing may be achieved by a resolution at the ECC (or, more formally, a Declaration under Article 33(1) of the ECT).

4.2 *Transit Dispute Resolution*

As described above, the ECT has a set of dispute resolution procedures specifically designed for disputes concerning transit of Energy Materials and Products, in which the continuance of the existing flow of those materials and products is ensured and the length of procedures is relatively short. Even so, this mechanism has never been utilized to date, presumably due to the strict requirements for exhaustion of other remedies prior to starting the ECT's procedures. It would be useful to consider what measures would encourage the Contracting Parties to utilize them.

Article 7(7) of the ECT provides that the transit dispute resolution procedures may be initiated "only following the exhaustion of all relevant contractual or other dispute resolution remedies previously agreed between the Contracting Parties party to the dispute". There have been discussions for a long time as to whether

[34]The Energy Charter website, "What We Do", Dispute Settlement, All Investment Dispute Settlement Cases http://www.energycharter.org/what-we-do/dispute-settlement/all-investment-dispute-settlement-cases/.

[35]The ICSID's website https://icsid.worldbank.org/apps/ICSIDWEB/cases/Pages/AdvancedSearch.aspx.

[36]Article 26(4) of the ECT.

this requirement for exhaustion of pre-agreed dispute resolution remedies encompass (i) those agreed under a treaty or an agreement that is not specifically related to the disputed transit (e.g., bilateral investment treaty), and (ii) the state-to-state dispute resolution proceedings stipulated in Article 27 of the ECT. Both of these proceedings could take a significant amount of time, and thus, would undermine the advantage of promptness envisaged in the transit-specific dispute resolution mechanism under Article 7 of the ECT.

Unlike the notification of investor-state arbitration discussed above, the lack of clarity as to the scope of the exhaustion of pre-existing dispute settlement remedies is a matter of interpretation of the existing provision in the ECT, rather than adding a new element. In order to keep this chapter concise, the author does not go into the details of treaty interpretation rules specified in the Vienna Convention on the Law of Treaties (Vienna Convention). However, it seems possible (though not necessarily easy) to argue that the mechanisms described as (i) and (ii) above are not included in the pre-agreed remedies to be exhausted under Article 7(7) of the ECT, considering, *inter alia*, (a) the purpose of the ECT (that is, to "establish[] a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the [European Energy] Charter"[37]) and (b) the evolution of the text of Article 7(7) of the ECT (during the drafting negotiations, the phrase "any contractual or other dispute resolution remedies"[38] was changed to "all relevant contractual or other dispute resolution remedies"[39] (emphases added)). Nevertheless, the author notes that a more straightforward solution here would be to adopt a resolution at the ECC to confirm this understanding, as a "subsequent agreement between the parties regarding the interpretation of the treaty" as set out in Article 31(3)(a) of the Vienna Convention.

5 Conclusion

Although there are some overlaps with the contents of the WTO Agreements and the ECT, the fact that a combination of rules regarding the international trade in energy, the comprehensive protection of investments in the energy sector, and the transit-specific provisions is shared by approximately 50 states defines the unique nature of the ECT. The author would prefer that the ECT's advantages would be recognized more broadly, and notes that the adoption of the 2015 Charter and the interests of newcomers communicated through their participation as observers may contribute to the vitalization of the dynamics at the Energy Charter Process. That could enhance the ECT's importance and contribute to the efforts to address the unsolved problems.

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[37] Article 2 of the ECT.

[38] The Interim Text of the ECT, dated 25 June 1994.

[39] The ECT Text for Adoption, dated 14 September 1994.

Chapter 14
Changes in Cycles and Risks of Circumvention? Comments to Chapter "Special Agreements and Energy: Filling the Gaps"

Tomohiko Kobayashi

Abstract This comment focuses on the blurring distinction between "trade in goods" and "trade in services" that may jeopardize effective functioning of international disciplines under the WTO, FTAs and the Energy Charter Treaty. Referring to the *Eurodif v. US* case in the United States, it casts light on the contemporary debates over the concept of goods and services that both international regimes originally took for granted. It also takes not of the International Energy Charter adopted in May 2015 and ongoing negotiations for the Environmental Goods Agreement.

Keywords Anti-circumvention • Trade in services • Anti-dumping • Energy charter treaty • International energy charter • Rules of origin • Environmental goods agreement

1 Introduction

Following the development and diversification of energy cycles, international disciplines on energy trade are gradually developing through the World Trade Organization (WTO), free trade agreements (FTAs) and the Energy Charter Treaty (ECT), as is shown in Professors Harn and Holzer's chapter (2016). On the other hand, the risk of circumvention is becoming an increasing concern, because the more the law develop, the more people tend to avoid it. In this context, *Eurodif v. US* case in the United States provides us an interesting insight with regard to the effective regulation of trade in services in energy field.

As is already noted by commentators, distinction between trade in goods and trade in services, which trade agreements once took for granted, is not clear any

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_14

more. In this context, how and to what extent should we address the risk of circumvention in a rapidly developing field of energy trade?

2 Revisiting Debates on Circumvention in *Eurodif v. US* Case

To obtain low enriched uranium (LEU) used in fuel rods for nuclear power plants, electric utility companies have two options. One is purchasing enriched uranium product (EUP), and the other is purchasing separable work unit (SWU) that consists of (i) sending unenriched uranium to enricher and (ii) receiving LEU produced by that enricher.

In an antidumping investigation against certain imports of LEU from abroad filed by the only US enricher, the US Department of Commerce (DOC) included LEU produced under the SWU contracts into the scope of the antidumping measure. French uranium enrichers led by Eurodif S.A. and a group of the US utility companies (Ad Hoc Utilities Group) filed a suit against the US government, arguing that LEU imported under SWU contracts are trade in services and categorically outside the scope of antidumping law.

19 U.S. Code § 1673 sets forth as follows:

> [i]f . . . the administering authority determines that a class or kind of foreign merchandise is being, or is likely to be, *sold* in the United States at less than its fair value, and [if the ITC found injury and causation] by reason of imports of that merchandise or by reason of *sales* (or the likelihood of sales) *of that merchandise* for importation, then there shall be imposed upon such merchandise an antidumping duty. . . For purposes of this section and section 1673d(b)(1) of this title, a reference to the sale of foreign merchandise includes the entering into of any *leasing arrangemen*t regarding the merchandise that is *equivalent to the sale of the merchandise*." Emphases added.

The findings of the lower courts, namely the Court of International Trade (CIT) and the Court of Appeals for the Federal Circuit (CAFC), were rather straightforward. First, the antidumping statute "unambiguously applies to the sale of goods and not services."[1] Secondly, the SWU contract is not a "sale of merchandise" because title of the uranium does not transfer from the utility companies to enrichers; it is not a "leasing arrangement" either. Thus, importation of LEU under the SWU contracts between US utility companies and foreign enrichers should be excluded from the scope of antidumping measures.

On the other hand, the unanimous Supreme Court judgment formulated the issue at hand as "not whether, for purposes of 19 U.S.C. § 1673, the better view is that a SWU contract is one for the sale of services, not goods."[2] Rather, it deferred to the administrative determinations by formulating the issue as whether the Department

[1] *Eurodif S.A. v. US*, 423 F.3d 1275, 1278.

[2] *US v. Eurodif S.A.*, 555 U.S. 305, 316.

of Commerce's determination was an "unreasonable resolution of language that is ambiguous," especially "in the absence of unambiguous statutory language to the contrary."[3]

According to the Supreme Court, a SWU contract is a scheme that utility company provides *fungible* goods along with cash to the enricher in exchange for a delivery of *substantially transformed* goods.[4] More specifically, the Court found that (i) "where a constituent material is untracked and fungible, ownership is usually seen as transferred, and the transaction is less likely to be a sale of services" and (ii) "when the manufacturer is not only free to return different material, but also substantially transforms the material it uses, it is even more likely that the object of the transaction will be seen as a new product, not work on enduring material of primary interest to the buyer."[5] Based on these factors, the Supreme Court upheld the DOC's determination. Additionally, it stated that the DOC's interpretation is "reinforced by practical reasons aimed at preserving the effectiveness of antidumping duties," or otherwise, utility companies can easily avoid disciplines of anti-dumping statutes by restructuring purchase of LEU from goods contracts to services contract, resulting in an "absurd result."[6]

Note that the Supreme Court did not interpret antidumping statute to include trade in services into the scope of antidumping measures. But it opened the door for the investigating authorities to treat a contract a sale of goods, if a customer provides fungible raw material used by a manufacturer to make the good and then delivers back to the customer, especially if the process involves substantial transformation. One might speculate the true motive of the Supreme Court to have changed the formulation of the issue being on an attempt to combat the risk of circumvention.

It is true that "[s]urrender to private contractual terms is especially uncalled for in dealing with international tariffs" and "public law is not constrained by private fiction."[7] However, concerns for fraudulent use of SWU contracts had been raised by the US government during the lower court proceedings. Lower courts indicated the US government may use "scope determination" procedure.[8] Even if a single scope determination proceeding cannot capture all fraudulent imports, courts have jurisdiction to such cases "capable of repetition, yet evading review" later on, as is

[3]*Id.*

[4]*Id.*, 319–320.

[5]*Id.*, 320–321.

[6]*Id.*, 321–322.

[7]*Id.*, 318. The US government noted "the whole purpose of the antidumping statute is to prevent contracting parties from entering into arrangements that are mutually beneficial to themselves, but that would and unfairly disadvantage domestic competitors, it was appropriate for Commerce to look behind the form of the contract and to look at physical and economic reality." Statement of the US government representative during the oral hearing in front of the US Supreme Court, November 4, 2008, at 15–16. Available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/07-1059.pdf. Accessed December 31, 2015.

[8]*Eurodif S.A. v. US*, 506 F.3d 1051, 1054; *Eurodif S.A. v. US*, 431 F.Supp.2d 1351, 1356.

noted by the CAFC.[9] Furthermore, during the oral hearing, CAFC judges pointed out that the US government may file criminal fraud accusations to address knowingly fraudulent use of SWU contracts, which may result in imprisonment up to 15 years and/or fines.[10] Also, the DOC might use anti-circumvention review for this purpose.[11] The CAFC found these concerns not ripe, refraining from making any substantive analysis,[12] because the US government failed to show any concrete risk of circumvention for the specific SWU contracts in question, let alone SWU contracts in general.[13] Overall, reliance on "fungibility" of raw materials in determining the nature of contracts is at best weak. Why did the US Supreme Court reverse the CAFC judgment for the first time in cases involving international trade on that basis? It might be partly due to tactical errors by Eurodif.[14]

In any way, allowing investigating authorities a departure from the clear statutory language on account of mere potential concerns of circumvention is not fully convincing and would raise another concern for abuse of regulatory powers on the part of the investigating authorities. For example, tax authorities conduct much more stringent analyses to address tax avoidance by means of contractual, organizational and/or financial restructuring techniques. Also, the Supreme Court ruling does not close potential loopholes, if utility companies and enrichers somehow arrange to trace unenriched uranium feed throughout the enrichment process. Finally, determination of "substantial transformation" is a difficult issue as is shown in the context of rules of origin. Whether the Supreme Court's interpretation

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[9]*Eurodif S.A. v. US*, 506 F.3d 1051, 1055.

[10]Oral argument in front of the CAFC, February 7, 2007. Available at http://oralarguments.cafc.uscourts.gov/default.aspx?fl=2006-1527.mp3. Accessed December 31, 2015.

[11]For example, in terms of addressing minor alterations, the DOC may consider factors including "the nature of the production process in the foreign country" and "whether the value of the processing performed in the foreign country represents a small proportion of the value of the merchandise imported into the United States" in accordance with 19 U.S.C. 1677j(b)(2).

[12]*Eurodif S.A. v. US*, 506 F.3d 1051, 1055.

[13]See *Eurodif S.A. v. US*, 411 F.3d 1355, 1364.

[14]Eurodif's counsel contended in front of the Supreme Court "Section 1677(a) defines 'export price' and 'constructed export price' as the price at which the subject merchandise is first sold in the United States" and the utility companies "consume that fuel in their reactors" without "sell [ing] it onward as the company would sell a sweater or would sell a pasta or would sell Rya rugs," thereby falling outside the scope of the antidumping statute. Statement by the Eurodif counsel during the oral hearing in front of the US Supreme Court, November 4, 2008, at 41–42. Available at http://www.supremecourt.gov/oral_arguments/argument_transcripts/07-1059.pdf. However, 19 U.S.C. 1677a(a) defines the term "export price" as "the price at which the subject merchandise is first sold (or agreed to be sold) before the date of importation by the producer or exporter of the subject merchandise outside of the United States to an unaffiliated purchaser in the United States or to an unaffiliated purchaser for exportation to the United States. . .." Thus, this argument is not correct at least for calculating export price for the transactions between unaffiliated parties, and potentially made the Eurodif's position as if sticking to contractual manipulation, prioritizing form over substance.

of substantial transformation is reconcilable with the WTO panel findings in *US – Underwear* case is another problem.[15]

Thus, the precedential value of the US Supreme Court judgment in *Eurodif* case would be limited. It hardly solved the circumvention issue and left the core problem, i.e., distinction between goods contract and services contract, largely unanswered.

3 Lessons Learned

Then, what can we learn from Eurodif case? Sooner or later, we will encounter similar problems in the international sphere. Along with nuclear materials, some biomass energy sources would be used mainly for captive consumption after importation. For example, seaweeds and jellyfish would be substantially transformed to become energy sources and would also require special facilities for consumption, less likely to be resold and used in ordinary factories or household.

Apparently, we need an integrated approach to trades in goods and services, to facilitate development of energy trade. Several trading powers have been prioritizing to liberalize energy-related services sectors through FTAs, in terms of services on commercial establishment and cross-border supply. However, energy services are in many cases excluded from the market access commitments and exempted from the MFN treatments. Also, the International Energy Charter adopted in May 2015 still leaves it an open question, although Article 3 of Title II thereof indicates harmonious approach to trades in goods and services for further liberalization of trade in energy. In this context, progress of the ongoing negotiations for the Environmental Goods Agreement since 2014, which Professor Harn addresses in his paper, is worth noting.

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[15]Mitsuo Matsushita, “Some International and Domestic Antidumping Issues,” 5(2) *Asian Journal of WTO & International Health Law & Policy*, 249, at 262–263 (2010).

Part VI
Subsidy Issues in Renewable Energy Trade

Chapter 15
The Climate-Trade Conundrum: A Critical Analysis of the WTO's Jurisprudence on Subsidies to Renewable Energy

Huaxia Lai

Abstract Subsidies to solar and wind energy products are on the rise throughout the world, and have been at the heart of many vexing trade disputes under the World Trade Organization (WTO) framework. The *Canada – Renewable Energy/Feed-in Tariff* case (*Canada – FIT*) is the first case where the WTO Appellate Body has addressed the trade-climate conundrum with regards to renewable energy subsidies. The Appellate Body's ruling in this case struck down the discriminatory "domestic content requirement" of the feed-in tariff program, but kept the rest of it intact. To better understand the ruling's implications for future climate support schemes, this paper first presents a comprehensive overview of the WTO's past jurisprudence on subsidy issues, and then critically evaluates the Appellate Body's ruling on renewable energy subsidies in the *Canada – FIT* case. The key question to be examined concerns whether the Appellate Body engaged in overly activist interpretation in its benefit analysis. This paper argues that although the Appellate Body took an activist approach in creating a separate benchmark market for renewable energy, this evolutionary approach is warranted by the uniqueness of the renewable energy sector and the interpretive rules embodied in the Vienna Convention on the Law of Treaties. The Appellate Body's ruling in this case represented the WTO Appellate Body's efforts to adapt to the pressing policy considerations on climate change, and to reconcile the climate support subsidies with its restrictive jurisprudence on subsidies under the Agreement on Subsidies and Countervailing Measures.

Keywords WTO • Climate change • Subsidies • Renewable energy • Benefit analysis

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_15

1 Introduction

With climate change being placed at the top of the global agenda, developing renewable energy has become a crucial task for governments of many countries. Developing renewable energy facilitates climate change mitigation and strengthens energy security. More importantly, it serves national governments' strategic interest in staying ahead of future economic competition. Historically, technological innovation in the production and use of energy has been central to improvement in economic efficiency and living standard. Today, developing renewable energy has become a defining issue of global competition. But developing renewable energy faces many hurdles: private investors are generally reluctant to engage in renewable energy projects; global subsidies for fossil fuels remain several times higher than those for renewable energy.

As an important industrial policy to develop renewable energy, subsidies to solar energy are on the rise throughout the world. Such subsidies are at the heart of many vexing trade disputes, including national trade remedies and separate litigations at the World Trade Organization (WTO). Six out of the fifteen complaints filed under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) involved renewable energy since 2010.[1] Though the WTO rules generally disfavor industrial policies such as subsidies, not all subsidies to renewable energy are contentious. It is difficult to draw a clearly defined line between "legitimate" government activities, on the one hand, and trade-distorting subsidies, on the other. The *Canada – Renewable Energy/Feed-in Tariff* (*Canada – FIT*) case is the first and so far the only case where the Appellate Body put renewable energy subsidies under scrutiny. It is important to analyze the Appellate Body's jurisprudence on subsidies in general, and provide a critical evaluation of its rulings in the present case. The key question to be examined concerns whether the WTO Appellate Body was overly activist in adjudicating the *Canada – FIT* case. The paper argues that the Appellate Body deviated from prior jurisprudence in its benefit analysis, yet this evolutionary approach was justified by the uniqueness of the energy market and the interpretive rules embodied in the Vienna Convention on the Law of Treaties (VCLT). The Appellate Body's ruling in this case represented the WTO's effort to adapt to climate change, and to reconcile the climate support subsidies with the restrictive disciplines on subsidies under the SCM Agreement.

The paper proceeds as follows. Part Two explains why should we be concerned with the WTO Appellate Body's ruling in one case. Part Three surveys the background of renewable energy subsidies and the basic facts and proceedings of the *Canada – FIT* case. Part Four reviews WTO's jurisprudence on subsidies and the Appellate Body's decision in the case. Part Five critically evaluates the Appellate Body's decision in the present case and its relation with past jurisprudence. Last section concludes with implications of the *Canada – FIT* case.

[1] Sherzod Shadikhodjaev, *First WTO Judicial Review of Climate Change Subsidy Issues*, 107 (4) Am. J. Int'l L. 864, 867 (2013).

2 Jurisprudence of the WTO Appellate Body – Why Does It Matter?

Multilateral treaties are like contracts countries negotiate to achieve common goals. After the treaties come into force, the dispute settlement body designated in the treaty will adjudicate on disputes by looking at the treaty texts. The treaties are usually left deliberately vague and abstract to accommodate to the diverse interests of the contracting countries.[2] Thus, the interpretive method becomes a key issue in dispute settlement at international tribunals.

The issue of treaty interpretation has attracted scant attention from international relations (IR) scholarship. This is partly explained by IR's emphasis on the power dynamics and the institutional design of international tribunals. Classic realist theories see international tribunals as agents of nation states, and international law as tools of national interests. States enter into international treaties and comply with international law only when it is in their interest to do so. More recently, neo-institutionalism theorizes that states enter into treaties to achieve mutually beneficial outcomes. They forsake short-term efforts to maximize power in favor of pursuing long-term goals. International law plays a functionalist role by making states' commitments more credible and help to resolve problems of coordination. Under neither framework does international law enjoy much autonomy. It is therefore no surprise that IR scholarship has been focusing on explaining why states enter into treaties and how they comply with treaty obligations, but has largely overlooked the interpretation of the treaty obligations.

International law scholarship takes treaty interpretation a lot more seriously. Just like their domestic counterparts, international tribunals primarily engage in interpreting legal texts. International treaties, compared with national statutes, tend to be more ambiguous. They are also characterized with a higher level of rigidity, because "legislative correction" of international tribunals has to be effected by nation states based on the consent rule.[3] The ambiguity and rigidity of international treaties makes the tribunal's treaty interpretation an essential aspect of the process of international law. The tribunals' sensitivity to nation states' sovereignty further enhances the significance of their choice of treaty interpretative methods. After all, nation states are wary of delegating expansive discretionary power to international tribunals, and include in the design of the tribunals institutional features that make adjudication a deferential enterprise.

The WTO dispute settlement body has been widely recognized as a highly legalized international tribunals. Under the WTO model, a report of the dispute settlement body is adopted automatically unless WTO members decide to reject it by consensus. This "negative consensus" mechanism replaced the diplomatic

[2] Joost Pauwelyn & Manfred Elsig, *The Politics of Treaty Interpretation: Variations and Explanations across International Tribunals*, *in* Interdisciplinary Perspectives on International Law and International Relations: The State of Art 445, 447 (Jeffrey L. Dunoff and Mark A. Pollack eds., 2013).

[3] *Id*.

model of dispute settlement under the General Agreement on Tariffs and Trade (GATT) with "a far more legalized and fundamentally adjudicative" one.[4] The present dispute settlement system regularly clarifies ambiguities and fills gaps by relying on interpretive rules set forth in the Vienna Convention on the Law of Treaties (VCLT), and sometimes resorting to principles of public international law that are extrinsic to terms in WTO agreements.[5]

International tribunals' legal reasoning and interpretative method not only applies to the dispute at issue, but also builds a body of law that bears on future litigations. Although international law does not have a strict *stare decisis* precedent system, previous decisions and doctrines are highly persuasive in WTO jurisprudence. Formally speaking, previous panel and Appellate Body decisions are not binding on future cases. Article IX:2 of the WTO Agreement provides that "the Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements."[6] In practice, however, *stare decisis* operates in a de facto sense.[7] The WTO Panels have rarely deviated from prior Appellate Body rulings, and the Appellate Body have included extensive references to prior case law in order to support its position in cases with factual similarities.[8] It is also a long-standing practice among the parties in dispute settlement proceedings to rely on previous decisions to support their arguments.[9]

International tribunals are often called upon to adjudicate on controversies with pressing policy considerations on which either the establishing treaties do not explicitly articulate the rules or there are no external international legal authorities to refer to. In the *Canada – FIT* case, the WTO Appellate Body was called upon to address the tension between climate mitigation measures and discriminatory trade rules. Countries have so far made only limited progress in negotiating a global legal framework on climate change that has enforcement authority. Even the most recent Paris Agreement, though widely hailed as a landmark, does not include any dispute settlement provisions.[10] Thus, how the WTO Appellate Body interprets the WTO legal texts in adjudicating the *Canada – FIT* dispute provides a great opportunity

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[4]Richard H. Steinberg, *Judicial Lawmaking at the WTO: Discursive, Constitutional, and Political Constraints*, 98(2) Am. J. Int'l L 247, 250 (2004).

[5]*Id.*

[6]Marrakesh Agreement Establishing the World Trade Organization art. IX:2, Apr. 15, 1994.

[7]*See* Raj Bhala, *Precedent Setters: De Facto Stare Decisis in WTO Adjudication (Part Two of a Trilogy)*, 9 J. Transnat'l L. & Pol'y, 1–151 (1999).

[8]Mitsuo Matsushita, Thomas J. Schoenbaum, Petros C. Mavroidis & Michael Hahn, The World Trade Organization: Law, Practice and Policy 76 (3rd ed. 2015).

[9]Felix David, *The Role of Precedent in the WTO-New Horizons?* Maastricht Faculty of Law Working Paper No. 2009–12, at 19.

[10]United Nations Framework Convention on Climate Change, Adoption of the Paris Agreement, UN Doc. FCCC/CP/2015/L.9/Rev.1 http://unfccc.int/documentation/documents/advanced_search/items/6911.php?priref=600008831 (Dec. 12, 2015).

for examining the autonomy of international tribunals. As the WTO Agreements do not cover the issue of climate change and there was no case law with regards to climate change at the Appellate Body before the *Canada – FIT* case, it is important to analyze to what extent did the Appellate Body fill the gaps on climate and trade issues. The Appellate Body's legal reasoning in the *Canada – FIT* case will have lasting impacts on future WTO litigations of trade in renewable energy.

3 Subsidies to Renewable Energy: An Overview and the Canada – FIT Controversy at the WTO

3.1 Why Do Governments Engage in Subsidizing Renewable Energy?

The private sector plays an essential role in climate mitigation. Private sector remains the largest source of global climate finance, and invested USD 193 billion, or 58 % of total flows in 2013.[11] Technological innovations achieved by the private sector are the key to the transition to clean production. Competition pressure fueled by the private sector engagement is also critical to the success of phasing-out carbon-intensive manufacturing. The United Nations Framework Convention on Climate Change (UNFCCC) has on many occasions recognized the contribution from the private sector to climate mitigation and seeks to encourage further engagement by the private sector.[12]

As the consumption of fossil fuels accounts for the majority of global anthropogenic greenhouse gases emissions,[13] developing renewable energy has become a crucial part of climate mitigation effort. Yet the private sector is faced with two primary barriers in investing in renewable energy industry. The first one involves the cost competitiveness between renewable and the traditional energy. It is difficult for renewable energy to compete with fossil fuels as globally subsidies to fossil fuels are estimated to reach USD 600 billion annually.[14] High upfront cost and lack of information and skilled labor also discourages private investors from engaging. The second major barrier involves the uncertainties in the regulatory framework.

[11]Climate Policy Initiative, *The Global Landscape of Climate Finance 2014*, at VI (Nov 2014), http://climatepolicyinitiative.org/wp-content/uploads/2014/11/The-Global-Landscape-of-Climate-Finance-2014.pdf

[12]*See* for example UNFCCC, *Bali Action Plan*, COP Decision 1/CP.13, UN Doc. FCC/CP/2007/6/Add.1. http://unfccc.int/resource/docs/2007/cop13/eng/06a01.pdf (Mar. 14, 2008).

[13]Intergovernmental Panel on Climate Change, *Special Report on Renewable Energy Sources and Climate Change Mitigation*: *Summary for Policy Makers and Technical Summary*, at 7 (2011), http://www.ipcc.ch/pdf/special-reports/srren/SRREN_FD_SPM_final.pdf

[14]International Institute for Sustainable Development, *Fossil Fuels – At What Cost*? (12 Feb 2012), https://www.iisd.org/gsi/fossil-fuel-subsidies/fossil-fuels-what-cost (last visited Jun.12, 2015).

Legislative actions have been lagging in including the negative environmental externalities in the price of carbon. Even if they do, it is often subject to shifting politics when different administrations come to power.[15]

Subsidizing is essential to overcome the underinvestment problem in developing renewable energy. Subsidies to renewable energy have been conceptualized as green subsidies in international trade literatures. Green subsidies are the allocation of public resources for the purpose of improving environmental sustainability over what would otherwise occur via the market.[16] The first major movement toward green subsidies came in the wake of the 2008 financial crisis, as part of national efforts to stimulate the economy. Hundreds of billions of dollars were injected into the clean energy sector by governments of the EU, US and China, to name the biggest spenders. Economically, subsidizing renewable energy is less efficient than levying carbon tax. Green subsidies, as most forms of subsidies, also create opportunities for rent seeking and capture of policy-making processes by vested interests.[17] As the public in general disfavors carbon tax, deploying subsidies to renewable energy sector seems a more popular policy instrument. Thus, subsidizing remains the most important policy tool in correcting the distortions introduced by fossil fuel subsidies.

Green subsidy is by nature an industrial policy employed by national governments to stay ahead of the global competition in developing renewable energy. In Gerschenkronian terms, protectionist industrial policy has been a defining feature of the "catch-up" phase of the latecomers' political economy throughout the nineteenth and twentieth century.[18] The developmental state plays an activist role by creating institutions conducive to economic growth in countries late to industrialization. Though vehemently discredited by the Washington Consensus, industrial policy is back in the twenty-first century with a green twist.[19] Policy makers have been aggressively pursuing industrial policies to develop renewable energy in the name of climate change, believing that renewable energy is the key to success in the new round of international competition. To associate renewable energy with international competition is well justified, as the histories of steam engines and

[15]It is often up to specific national context to explain why a certain country fails to develop any renewable energy policy. For example, both structural element such as separation of power and cultural element like free market ideology has been invoked to account for the absence of renewable energy policy in the United States. *See* E. Donald Elliott, *Why the United States Does Not Have a Renewable Energy Policy*, 2–2013, Envtl. L. Rep.

[16]*See* Steve Charnovitz, Green subsidies and the WTO, *World Bank Policy Research* Working Paper 7060 (2014), http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/10/14/000158349_20141014095048/Rendered/PDF/WPS7060.pdf (last visited Jun.12, 2015).

[17]Aaron Cosbey and Petros C. Mavroidis, *A Turquoise Mess: Green Subsidies, Blue Industrial Policy and Renewable Energy: the Case for Redrafting the Subsidies Agreement of the WTO*, 17 J. Int'l Econ L. 11, 43 (2014)[hereinafter Cosbey and Mavroidis].

[18]*See* Alexander Gerschenkron, *Economic backwardness in historical perspective* (1962).

[19]Dani Rodrik, The return of industrial policy, *Project Syndicate* (Apr. 12, 2010), http://www.project-syndicate.org/commentary/the-return-of-industrial-policy.

electricity have illustrated that innovation in energy use and development is the key to economic prosperity and competitiveness.[20]

3.2 FIT as a Popular Form of Renewable Energy Subsidies

Renewable energy subsides are generally provided to producers in the form of FIT programs. FIT program is an energy-supply policy that supports the development of new renewable power generation. FIT programs typically include three features: guaranteed electricity purchase prices, guaranteed grid access and long-term contracts.[21] Under a FIT program, eligible renewable energy producers, be they business owners, farmers, or homeowners, are paid a cost-based price for the electricity they supply to the grid. They are also guaranteed a long-term (15–25 years) purchasing contract from the electricity grid. These features are designed to incentivize the private sector to invest in renewable energy by ensuring long-term economic returns. Besides bringing predictability to private investors, FIT can also encourage technological learning.[22]

German FIT programs, for example, have demonstrated great success in facilitating investment from the private sector into developing renewable energy. In Germany, FIT was first brought in as part of the *Stromeinspeisungsgesetz* (StrEG), and since 2000 has been part of the *Erneuerbare Energien-Gesetz* (EEG).[23] The EEG guarantees access to the grid and provides predictable and attractive rates to both business and community.[24] Between 1990 and 2003, the proportion of renewable energy in Germany's electricity fuel mix increased from 3 to 9 %. Between 2003 and 2010, renewable energy production almost doubled, and accounted for 17 % of Germany's electricity portfolio in 2011.[25] Besides boosting private investment in renewable energy, German FIT programs also create numerous jobs in related manufacturing industries.[26]

Governments usually attach local content requirements as preconditions for participating in FIT programs. In order to be eligible for participating in FIT

[20]Richard G. Newell, *The Energy Innovation System: A Historical Perspective*, *in* Accelerating Energy Innovation: Insights from Multiple Sectors (Rebecca M. Henderson and Richard G. Newell eds., 2011).

[21]Marie Wilke, *Feed-in Tariffs for Renewable Energy and WTO Subsidy Rules: An Initial Legal Review* (2011) ICTSD Programme on Trade and Environment; Trade and Sustainable Energy Series, Issue Paper No. 4, at.1.

[22]Warren E. Mabee et al., *Comparing the Feed-in Tariff Incentives for Renewable Electricity in Ontario and Germany*, 40 Energy Policy 480, 481 (2012).

[23]*Id*. at 480.

[24]*Id*. at 482.

[25]*Id*. at 484.

[26]*Id*. at 480.

programs, renewable energy producers must source a certain percentage of their equipment and other production material inputs from domestic producers, and are discouraged from using foreign solar panels or wind turbines.[27] The local content requirements are typical discriminatory industrial policy tools, which was one of the core claims in the *Canada – FIT* case. Participating in FIT programs are also contingent on a few other terms, such as purchasing all renewable energy from nearby grid. This obligation is less controversial than local content requirements, but it still favors domestic production of energy.[28]

3.3 The Canada – FIT Controversy: Facts and Proceedings

The Appellate Body's decision in *Canada – FIT* was the first time that WTO addressed the subsidy issue in the context of renewable energy and climate change. This case concerned the electricity generating system of the province of Ontario, Canada. In 2009 the provincial government of Ontario launched a FIT program through the enabling *Green Energy and Green Economy Act* in 2009. Under the Ontario FIT program, the Ontario electrical generating system accommodated to electricity generated from sources such as wind and photovoltaic solar panels. The Ontario Power Authority (OPA) was entrusted with the authority to implement the FIT program, including price setting and administration of contracts.[29] The FIT program offered guaranteed rates for electricity generated from renewable sources delivered into the Ontario grid under 20-year or 40-year contracts with OPA.

The Ontario FIT program was expected to serve several goals: to mitigate climate change by phasing out fossil fuel energy, to facilitate the development of renewable energy in Ontario, and to create new jobs.[30] In order to achieve the second and the third goals, the OPA imposed local content requirement on electricity generators participating in the FIT program. Unless the generators used a minimum percentage of Ontario-produced "renewable energy generation equipment" (e.g. Ontario-made wind turbines or solar panels) in developing and constructing their generation facilities, they were not eligible to participate in the Ontario FIT program.[31] The Government of Ontario signed a $7 billion green energy

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[27]*See* Henok B. Asmelash, *Energy Subsidies and WTO Dispute Settlement: Why Only Renewable Energy Subsidies Are Challenged*, 18 J. Int'l Econ L. 1–25 (2015).

[28]Luca Rubini, *Ain't Wastin'Time No More: Subsidies for Renewable Energy, the SCM Agreement, Policy Space, and Law Reform*, 15 J. Int'l Econ L., 1, 30 (2012).

[29]Wilke, *supra* note 21, at 3.

[30]Kent Avidan and Vyoma Jha, *Keeping Up with The Changing Climate: the WTO's Evolutive Approach in Response to the Trade and Climate Conundrum*, 15 The J. World Investment & Trade 245, 254 (2014) [hereinafter Avidan & Jha].

[31]Rajib Pal, *Has the appellate body's decision in Canada – Renewable energy/Canada–Feed-in Tariff Program opened the door for production subsidies*? 17 J. Int'l Econ L. 125, 126 (2014).

deal with Samsung, promising Samsung the preferential access to the grid and procurement of heavily-subsidized power from Samsung. In return, Samsung agreed to build plants to manufacture components for wind and solar projects in Ontario.[32]

Japan and the European Union challenged Ontario's FIT program at the WTO in 2010 and 2011 respectively. The two disputes were then adjudicated simultaneously before the same panel. The complainants argued that Ontario's FIT program was inconsistent with Canada's obligation under the following provisions:

1. Articles 3(1)(b) and 3(2) of the SCM Agreement, because the measures provide prohibited subsidies that are contingent on domestic content;
2. Article III:4 of the GATT 1994, because the measures accord less favorable treatment to imported equipment over like products originating in Ontario; and
3. Article 2.1 of the Agreement on Trade-Related Investment Measures (TRIMs Agreement), because the measures require purchase of equipment of Ontario origin.[33]

The Panel in its 2012 report held that the domestic content requirement in Ontario's FIT program was in violation of the "national treatment" provisions under both the GATT and the TRIMs Agreement.[34] The Panel split on what constituted the "prevailing market conditions" for electricity generated from renewable sources.[35] Japan, EU, and Canada each appealed certain issues in the Panel's report to the Appellate Body. The Appellate Body issued its report in 2013.

4 The DSB's Holdings in the Canada – Fit Case

4.1 WTO Jurisprudence on Subsidies Under the SCM Agreement

To better understand the WTO Appellate Body's ruling in the *Canada – FIT* case, it is necessary to provide a structural review of WTO's jurisprudence on subsidies. Article 1 of the SCM Agreement defines a subsidy as having three necessary components: (1) a "financial contribution"; (2) the contribution was made by a government or a public body; and (3) the contribution confers a benefit.[36] Article

[32]Keith Leslie, *Ontario-Samsung Green Energy Deal Dubbed 'Colossal Failure'*, Global News, (June 20, 2013) http://globalnews.ca/news/658399/ontario-samsung-deal-slashed-by-3-7-billion.

[33]Request for Consultations by the European Union, *Canada – Measures Relating to the Feed-in Tariff Program*, WT/DS426/1 (Aug. 11, 2011).

[34]Panel Report, *Canada – Certain Measures Affecting the Renewable Energy Generation Sector/Canada - Measures Relating to the Feed-in Tariff Program*, 7.166, WT/DS412/R, WT/DS426/R (Dec.19, 2012) [hereinafter Panel Report, *Canada – FIT*].

[35]*Id*. 9.23.

[36]Agreement on Subsidies and Countervailing Measures art.1, Apr. 15, 1994 [hereinafter SCM].

2 further provides that the SCM Agreement's operative provisions only apply to subsidies that are specific to a certain enterprise or industry or to a group of enterprises or industries.[37] In other words, a subsidy is defined as financial contribution by a government body that confers a benefit to a specific enterprise or industry. Article 3 of the SCM Agreement provides that a subsidy is prohibited if it is contingent upon the export performance or local content requirements.[38]

4.1.1 Financial Contribution

The WTO adopts an expansive interpretation of the "financial contribution" component, and covers both direct and indirect forms of financial contribution. Article 1.1(a)(1) lists four types of financial contribution, with paragraphs (i)-(iii) on direct subsidy and paragraphs (iv) on indirect subsidy. Direct financial contributions, under Article 1.1(a)(1), cover direct transfer of funds from the government, foregone government revenue that is otherwise due, and goods and services provided by the government other than infrastructure.[39] Indirect financial contributions cover government payment to a funding mechanism or a private body.[40] In the *United States – Treatment for "Foreign Sales Corporations"* case, the Appellate Body ruled that deductions for certain foreign-sales corporations, when they meet certain condition were "foregone government revenue" and thus constituted a subsidy under Article 1.1(a)(1).[41]

4.1.2 Benefit

The second element necessary to the determination of a subsidy is the conferral of "benefit." It requires establishing that the recipient is "better off" than it would have been without the contested measures. The WTO jurisprudence on benefit analysis has been highly consistent in examining benefit from the recipient's side, as distinct from the question of financial contribution.

The Appellate Body clarified this rule in its report on the *Canada – Civilian Aircraft* case.[42] In this case, the challenged measure was the Canadian Export Development Corporation (EDC), a public body created by the Canadian government that gave preferential credits to Canadian manufactures of civilian aircrafts.

[37] SCM art. 2.

[38] SCM art. 3.

[39] SCM art. 1.

[40] SCM art. 1.

[41] Appellate Body Report, *United States – Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R (Feb.24.2000).

[42] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (Aug. 2, 1999) [hereinafter *Canada – Civilian Aircraft*].

Canada claimed that the subsidy should be interpreted as "cost to government," and in this case there was no cost incurred, but "an investment in which the government is seeking long term return." The Appellate Body rejected Canada's "at no cost of government" defense, and ruled that a benefit arises when the recipient has received a "financial contribution" on terms more favorable than those available to the recipient in the market.[43] The rule that "benefit is determined from the recipient's side" was upheld in *US – Bismuth Carbon Steel Products from the United Kingdom*[44] and *US – Softwood lumber from Canada*.[45] All these cases illustrate that in determining if a certain measure confers benefit the Appellate Body solely focuses on the market condition as a point of comparison. This is in line with the WTO jurisprudence of focusing on market competitiveness in analyzing "like product."[46]

The benefit analysis becomes tricky when the market is too distorted by government interventions to serve as a benchmark for the purpose.[47] In such circumstances, the Appellate Body has opted to use alternative benchmarks. In *EC – Large Civil Aircraft*, the Appellate Body ruled that the benchmark must reflect the market condition absent the contribution.[48] In *US – Softwood Lumber IV*, the Appellate Body established that when the government is the predominant provider of goods or services, out-of-country prices may be used to determine the existence and size of "benefit,"[49]

4.1.3 Prohibited Subsidies

Article 3.1(a) of the SCM Agreement provides that both de facto and de jure contingency on export performance and local content shall constitute a prohibited subsidy.[50] Footnote 4 to Article 3.1 further clarifies what constitutes a de facto contingency. It is easier to determine if there exists de jure contingency than de facto contingency because the former is explicitly prescribed in law. To determine de facto contingency, the Appellate Body in the *EC – Large Civil Aircraft* case

[43] *Id*. at 157.

[44] *See* Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/AB/R (Oct.5, 2000).

[45] *See* Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, *Recourse by Canada to Article 21.5 of the DSU*, WT/DS257/AB/R (Dec.20, 2005).

[46] *See* Appellate Body Report, *Korea – Measures Affecting Imports of Fresh*, *Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R (Nov.12, 2000). Appellate Body Report, *Philippines – Taxes on Distilled Spirit*, WT/DS396/AB/R, WT/DS403/AB/R (Nov.21, 2011).

[47] Asmelash, *supra* note 27.

[48] *See* Appellate Body Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/AB/R (May.18, 2011), para. 900.

[49] *See* Appellate Body Report, *US-Softwood Lumber IV*, WT/DS257/AB/R, (Jan.19, 2004).

[50] SCM art. 3.1(a)

adopted an "objective test" that examines objective evidence (design, structure, modalities) rather than subjective motivation.[51]

4.2 Did the Domestic Content Requirement Violate the National Treatment Doctrine Under GATT and TRIMs Agreement?

Both the Panel and the Appellate Body had no trouble in concluding that the domestic content requirement of the Ontario's FIT program was inconsistent with Article III:4 of GATT, and Article 2.1 of the TRIMs Agreement.

The Panel first concluded that Ontario government's "procurement of electricity under the FIT program was undertaken 'with a view to commercial resale,'"[52] and therefore did not qualify as a government procurement exception under Article III:8 of the GATT to exclude application of Article III:4 of the GATT.[53] Next, the Panel concluded that the domestic content requirement of the FIT program violated national treatment doctrine provided in Article III:4 of the GATT and Article 2.1 of the TRIMs Agreement.[54] Canada did not appeal this part of the Panel's decision, and the Appellate Body upheld the Panel's conclusion that the domestic content requirement was inconsistent with Article 2.1 of the TRIMs Agreement and Article III:4 of the GATT 1994 stands.[55]

4.3 Did the Domestic Content Requirement Constitute Prohibited Subsidy Under the SCM Agreement?

To answer the question whether the domestic content requirement of the Ontario FIT program made it a prohibited subsidy, the Panel and the Appellate Body need first determine whether the FIT program was a subsidy under the SCM Agreement.

At the center of the dispute was whether the financial contribution conferred benefit, i.e. whether the conditions granted by the Ontario FIT program were more advantageous than the "prevailing market conditions" for electricity in Ontario.[56]

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[51] *See* Appellate Body Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/AB/R (May.18, 2011).

[52] Panel Report, *Canada – FIT*, 7.151.

[53] Id, 7.152.

[54] Id, 7.166.

[55] Appellate Body Report, *Canada - Certain Measures Affecting the Renewable Energy Generation Sector/Canada – Measures Relating to the Feed-in Tariff Program*, 5.85, WT/DS412/AB/R, WT/DS426/AB/R (May.6, 2013) [hereinafter AB Report, *Canada – FIT*].

[56] Avidan and Jha, *supra* note 30, at 256.

The key question to be determined was what constituted "prevailing market conditions." The complaints suggested wholesale/retail prices and prices in other jurisdictions as the correct market benchmark. The Panel found that according to the WTO jurisprudence the "prevailing market conditions" required "effective competition," "unconstrained operation," and free from "government intervention."[57] The Panel rejected the complaint's proposals, reasoning that the prices were distorted by government intervention.[58] The Panel then proposed its own benchmark for determining "prevailing market conditions." According to the Panel, the benchmark should take into account Ontario government's concerns for climate mitigation and clean energy.[59] The appropriate benchmark for FIT programs should be electricity generated from solar and wind power, not electricity generated from all sources. The Panel report reads:

> Thus, one way to determine whether the challenged measures confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement would involve testing them against the types of arm's length purchase transactions that would exist in a wholesale electricity market whose broad parameters are defined by the Government of Ontario. In the present set of circumstances, this could be done by comparing the terms and conditions of the challenged FIT and micro FIT Contracts with the terms and conditions that would be offered by commercial distributors of electricity acting under a government-imposed obligation to acquire electricity from generators operating solar PV and wind power plants of a comparable scale to those functioning under the FIT Programme.[60]

The Panel then concluded that EU and Japan failed to establish that the challenged Ontario FIT program conferred benefit, and consequently no subsidy was found absent benefit.

The most crucial problem that the Appellate Body was confronted was to review if the Panel ruled correctly over what constituted the relevant market for electricity generated from renewable sources. The Appellate Body, following the *EC – Large Civil Aircraft* jurisprudence, engaged in a two-prong analysis of the relevant electricity market, i.e. examining substitutability in both the supply side and the demand side of electricity generated from renewable sources.[61] On the demand side, the Appellate Body acknowledged that consumers could not distinguish between electricity generated from fossil fuels and electricity generated from renewable sources, because "all electricity fed into the grid is blended regardless of the energy generation technology used."[62] On the supply side, the Appellate Body found that conventional energy and renewable energy differed so profoundly in terms of "cost structures and operating costs characteristics" that it was "very unlikely, if not impossible" for "the former to exercise any form of price constraint on the latter."[63] Due to the significant

[57] Panel Report, *Canada – FIT*, ¶ 7.275.
[58] *Id.* 7.301.
[59] *Id.* 7.322.
[60] *Id.* 7.322.
[61] AB Report, *Canada – FIT*, 5.171.
[62] *Id.* 5.176.
[63] *Id.* 5.174.

differences, the Appellate Body concluded that "markets for wind- and solar PV-generated electricity can only come into existence as a matter of government regulation."[64] While the demand-side analysis favored a single market, the supply-side analysis favored treating the renewable energy market separately from conventional energy market. The Appellate Body concluded that "an appropriate benchmark should first be sought in the wind power and solar PV generation markets in Ontario."[65]

The Appellate body justified its decision to use a separate market to determine benefit in the following paragraph:

> Nevertheless, a distinction should be drawn between, on the one hand, government interventions that create markets that would otherwise not exist and, on the other hand, other types of government interventions in support of certain players in markets that already exist, or to correct market distortions therein. Where a government creates a market, it cannot be said that the government intervention distorts the market, as there would not be a market if the government had not created it. While the creation of markets by a government does not in and of itself give rise to subsidies within the meaning of the SCM Agreement, government interventions in existing markets may amount to subsidies when they take the form of a financial contribution, or income or price support, and confer a benefit to specific enterprises or industries.[66]

After determining that the appropriate market for electricity generated from renewable sources should be a separate renewable energy market, the Appellate Body proceeded to examine whether the FIT program conferred a "benefit" within the meaning Article 1.1(b) of the SCM Agreement. However, the Appellate Body concluded that there were not sufficient factual findings or uncontested evidence to complete the benefit benchmark comparison. It therefore ruled that it could not determine whether the Ontario FIT program conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement and whether they constituted prohibited subsidies inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement.[67]

5 Assessing the Appellate Body's Ruling in the Canada – FIT Case

The Panel and the Appellate Body did not find it difficult to strike down the discriminatory local content requirement. Unlike the rest of the FIT program that has an environmental rationale, the domestic content requirement is exclusively concerned with industrial development goals such as creating jobs and fostering infant renewable energy industry.

[64] *Id.* 5.175.
[65] *Id.* 5.227.
[66] *Id.* 5.188.
[67] *Id.* 5.246.

The heart of the Appellate Body's ruling, however, was not about the discriminatory domestic content requirement. Rather, it was the Appellate Body's analysis of benchmark market that had the most significant implications for future renewable energy development. To recap, the Appellate Body found that conventional energy generation and renewable energy generation differed profoundly[68] and that markets for renewable energy can only come into existence at the government intervention.[69] It found that the relevant market for electricity generated from renewable sources should be distinct from the conventional energy market, and observed "where a government creates a market, it cannot be said that the government intervention distorts the market, as there would not be a market if the government had not created it."[70] The Appellate Body's ruling in *Canada – FIT* represented a major development in the jurisprudence of benefit analysis in that it carved out another situation where an alternative benchmark for the benefit analysis should be used.[71]

5.1 Was the Appellate Body Overly Activist?

A number of scholarly commentaries have faulted the Appellate Body's approach in the *Canada – FIT* case as overly activist. In particular, it is argued that the Appellate Body deviated from its prior jurisprudence on the benefit analysis. The Appellate Body found that supply side analysis would support a separate market for renewable energy, and that the market for renewable energy would not have existed without the government's intervention. In doing so, the Appellate Body cited a paragraph from the Appellate Body report in *EC – Large Civil Aircraft* (para 1121), which was commented as "taken out of context."[72] The critique argued that analysis of substitutability on the supply side was relevant to determining serious prejudice, as in the *EC – Large Civil Aircraft* case, but irrelevant to determining benchmark market.[73] In addition, the Appellate Body had no basis for concluding that those supply side factors should outweigh the demand side factors for determining the relevant market. Even if the supply-side factors weighed in favor of defining the relevant market as the competitive market for renewable energy, the critique

[68]*Id*. 5.174.

[69]*Id*. 5.175.

[70]*Id*. 5.188.

[71]Dominic Coppens, *WTO Disciplines on Subsidies and Countervailing Measures: Balancing Policy Space and Legal Constraints* 75 (2014).

[72]Cosbey and Mavroidis, *supra* note 17, at 25.

[73]*Id*.

questioned why the converse reasoning could not be equally true.[74] As the Appellate Body did not sufficiently justify its preference, this seemed to evidence its leaning towards reaching a result that would exempt the Ontario Government's support for renewable energy from the disciplines of the SCM Agreement.[75]

Critiques also challenged that the Appellate Body had no basis to attach significance to the Government of Ontario's choice of energy supply-mix in its benefit analysis. Critiques found this to deviate from the counterfactual methodology articulated in the *EC – Large Civilian Aircraft* case.[76] In that case, the Appellate Body held that to determine whether a benefit exists requires a determination of "whether the financial contribution places the recipient in a more advantageous position than would have been the case but for the financial contribution."[77] In the *Canada – FIT* case, the Appellate Body instead included the government's choice of energy supply-mix in identifying the relevant market and put aside the counterfactual method. Critiques argued that the Appellate Body was creating a de facto exception for government intervention, which had no statutory underpinning under the SCM Agreement.[78]

Critiques believed that such an approach would have far-reaching implications for the SCM Agreement discipline. To allow for supply-side analysis in determining the relevant market, as it was claimed, would open the door wide for states to engage in industrial policies, which were inconsistent with the spirit of the WTO law.[79] In doing so, the Appellate Body "reinvented themselves as principals and decided what the law should be" instead of behaving as agents called to apply laws decided by the national government principals.[80]

International tribunal adjudicators, including the WTO Appellate Body members, face at least two interpretive choices: whether to interpret a contested provision and the method that should be used to interpret it.[81] The alleged judicial activism is characterized by gap filling and clarifying ambiguities. In contrast, the critiques on judicial activism are largely derived from the positivist tradition of international law that emphasizes adjudicators' deference to state consent and fidelity to the literal and express meaning of the treat languages. On whether to interpret a contested provision, it is commented that the WTO Appellate Body has leaned toward the more activist approach.[82] Those who support activism would cite policy arguments to support their less deferential position: WTO agreements are

[74] Pal, *supra* note 31, at 132–133.

[75] *Id*. at 133.

[76] Pal, *supra* note 31, at 133.

[77] Appellate Body Report, *Canada – Civilian Aircraft*, *supra* note 51, at 149.

[78] Cosbey and Mavroidis, *supra* note 17, at 27.

[79] *Id*. at 26.

[80] *Id*. at 12. Also *see* Liesbeth Casier and Tom Moerenhout, *WTO Members*, *Not the Appellate Body*, *Needs to Clarify Boundaries in Renewable Energy Support* (July 2013) https://www.iisd.org/pdf/2013/wto_members_renewable_energy_support.pdf (last visited Jun. 12, 2015).

[81] Steinberg, *supra* note 4, at 258.

[82] Steinberg, *supra* note 4, at 260.

filled with gaps and ambiguities; the negotiating process at the WTO is unable to come up with timely new agreements.[83] The Appellate Body, in choosing its interpretive method, refers to the general international law represented by the VCLT. It is observed that the Appellate Body, more than any other international tribunals, explicitly refers to the VCLT in almost every case.[84] The WTO Appellate Body has clearly adjudicated in an activist manner before.

5.2 Applicability of Article XX to the SCM Agreement

The *Canada – FIT* case has been highlighted as part of "the next generation of trade-environment conflict."[85] As the first WTO case in addressing the tension between international trade regime and climate change, it has to be understood in the context of the WTO's general jurisprudence on trade and environment under Article XX of GATT.

Article XX of the GATT stands at the center of trade-environment conflicts under the WTO framework. It outlines exceptions to member states' trade obligations for public policy purposes, and is of crucial normative value for the function of the GATT.[86] Article XX consists of a chapeau and a list of exceptions that are qualified by the chapeau. The chapeau provides that measures that can be excused under Article XX shall not be "arbitrary or unjustifiable discrimination," or "a disguised restriction on international trade."[87] Two exceptions are especially relevant to environmental protection. Article XX(b) of the GATT provides an exception for trade restrictions "necessary to protect human, animal or plant life or health," and Article XX(g) provides an exception for measures "relating to the conservation of exhaustible natural resources."[88] The chapeau serves the function of preventing member states from abusing the exception. The Appellate Body views the chapeau as protecting "both substantive and procedural requirements."[89] The balancing approach the Appellate Body uses has been commented as transforming Article XX into "an adequate tool for a balanced approach to the trade and environment controversy."[90] However, the high threshold set in the

[83]*Id.*

[84]Pauwelyn and Elsig, *supra* note 2.

[85]*See* Mark Wu and James Salzman, *The Next Generation of Trade and Environment Conflicts: The Rise of Green Industrial Polic*y, 108 Nw. U. L Rev. 410–474 (2013).

[86]Rubini, *supra* note 28, at 36.

[87]General Agreement on Tariffs and Trade art. XX, Oct. 30, 1947 [hereinafter GATT].

[88]*Id.*

[89]Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R (1998) [hereinafter *Shrimp/Turtle*], 160.

[90]Matsushita et al., The World Trade Organization: Law, Practice, and Policy 803 (2d ed. 2006).

chapeau analysis is also criticized as a "tightly guarded gateway" through which environmental measures will be rejected as trade restrictive.[91]

The Appellate Body report did not address the applicability of Article XX of GATT to the SCM Agreement in its ruling. After all, WTO Agreements other than the GATT usually do not have the exemption clauses as Article XX of the GATT. Until very recently, the WTO jurisprudence on Article XX's reach outside the GATT could be characterized as "avoiding to rule."

In *EC – Trademarks* and *EC – Biotech*, the defendant claimed that the challenged measures in violation of the TBT Agreement could be justified under Article XX of the GATT.[92] The Panels in both disputes found that the TBT Agreement was either inapplicable or that a prima facie claim of breach of the TBT Agreement had not been established. As such, the panels did not have to decide whether Article XX of the GATT could be applied to rehabilitate a violation of the TBT.[93] Similarly, in *United States – Customs Bond Directive for Merchandise Subject to Anti-Dumping/ Countervailing Duties*, the Appellate Body declined to complete the Article XX analysis.[94]

However, in *China – Raw Materials*, the Appellate Body established that GATT Article XX could be invoked outside of the GATT, when, and only when, the breached provision includes a direct reference to Article XX or language alluding to a general "right to regulate." It was commented that in *China – Raw Materials* the Appellate Body implicitly acknowledged that the various WTO agreements should be interpreted as a "harmonious whole,"[95] and created a rebuttable presumption against permitting the invocation of Article XX outside of the GATT.[96] Nevertheless, it is to be noted that cross application of Article XX in non-GATT agreement is permitted on a case-by-case basis rather than a general rule.

Overall, the presumption against cross application of Article XX is still valid. In this respect, the Appellate Body was not acting in an "overly activist" manner in that its ruling did not make any changes to the Article XX jurisprudence. Even assuming that Article XX could be invoked as a defense for claims brought forward under the SCM Agreement, it would be highly unlikely that the Ontario Government's FIT program would pass the two-tiered test. The justification under the

[91] Sanford E. Gaines, *The WTO's Reading of the GATT Article XX Chapeau: A Disguised Restriction on Environmental Measures*, 22 U. Pa. J. Int'l Econ. L. 739, 743 (2001).

[92] *See* Panel Report, *European Communities – Measures Affecting the Approval and Marketing of Biotech Products*, WT/DS291/R, WT/DS292/R, WT/DS293/R (Sept. 29, 2006); Panel Report, *European Communities – Protection of Trademarks and Geographical Indications for Agricultural Product and Foodstuffs*, WT/DS290/R (Mar. 15, 2005).

[93] EC – Biotech, *supra* note 92, 7.2524; EC – Trademarks, *supra* note 92, 7.437- 7.476.

[94] Appellate Body Report, *United States – Customs Bond Directive for Merchandise Subject to Anti-Dumping/Countervailing Duties*, 310, WT/DS345/AB/R (July 16, 2008).

[95] Danielle Spiegel-Feld and Stephanie Switzer, *Whither Article XX? Regulatory Autonomy under Non-GATT Agreements after China-Raw Materials*, 38 Yale J. Int'l L. 28 (2012).

[96] *Id*. at 27.

necessity test of the subparagraph has been described as "arduous,"[97] and the formalistic logic in the chapeau test makes the Article XX exemption even more restrictive.

5.3 The Appellate Body's Evolutionary Approach

Climate change is closely associated with the fast expansion of international trade, yet the international climate regime under the UNFCCC and the international trade regime under the WTO have remained relatively distant.[98] For the past 20 years, these two fields of public international law have evolved in parallel, and rarely engaged in institutional cooperation with each other.[99] The WTO has been under great pressure to make its trade rules more compatible with climate policies. The relationship between national policies to promote renewable energy, and WTO rules on subsidies and unfair trade practices in particular, seems to be emerging as the most acute testing ground for the compatibility between international trade rules and climate policies.[100]

The *Canada – FIT* case was the first time that the WTO addressed the trade-climate conundrum, from which we can have a chance to assess how the WTO jurisprudence accommodates climate concerns. The Appellate Body's approach in the present case seems to be responsive to the general critiques that desirable subsidies are not properly distinguished from undesirable subsidies under the WTO. It is important to clarify which subsides are allowed and which are not under the WTO regime so that the legal predictability will encourage national government to further their climate mitigation efforts.[101] Not all types of subsidies are destructive; subsidies designed for public goods can serve to correct market failures. The traditional energy market has been pervasively distorted by subsidies provided to producers and consumers of fossil fuels.[102] It is also a market in which existing networks for the distribution and retailing of energy have been largely designed to favor fossil fuels. In addition, subsidies schemes and tax systems have often led to a reduction in incentives for energy efficiency in that they relieve users

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[97]Christopher Doyle, *The Necessary Element of GATT Article XX in the Context of the Audiovisuals Products Case*, 29 B.U. Int'l L.J. 143, 145–48 (2011).

[98]Kati Kulovesi, *Real or Imagined Controversies? A Climate Law Perspective on the Growing Links Between The International Trade and Climate Change Regimes*, 6(1) Trade L. & Dev. 55, 57 (2014).

[99]*Id.*

[100]Kulovesi, *supra* note 98, at 59.

[101]*See* Robert Howse, *Climate Mitigation Subsidies and the WTO Legal Framework: A Policy Analysis* (May, 2010) https://www.iisd.org/pdf/2009/bali_2_copenhagen_subsidies_legal.pdf 1 (last visited Jun. 12, 2015).

[102]*See* Chris Wold et al., *Leveraging Climate Change Benefits Through the World Trade Organization: Are Fossil Fuel Subsidies Actionable*? 43 Geo. J. Int'l L. 635–693 (2011).

from paying the full marginal cost of an additional unit of energy.[103] In this context, subsidies to renewable energy can correct the distortion and reflect positive environmental externalities that would not otherwise be reflected.[104]

The Appellate Body's benefit analysis can be interpreted as establishing an exemption/shelter to the SCM Agreement for renewable energy subsides.[105] In completing the benefit analysis, the Appellate Body decided to take into account non-market components such as "positive externalities," "negative externalities," and government's definition of energy-mix, all of which were characteristic of environmental policies.[106] This was distinct from prior jurisprudence of benefit analysis that focused on market substitutability, an approach that was criticized as "myopic."[107] The Appellate Body ruling's interpretive ingenuity was remarkable. Its differentiation between the role of government in the creation of a market, on the one hand, and its role of intervention in an existing market, represented an important development in the subsidy jurisprudence. Under such a ruling, it would be more difficult to contest another WTO member's renewable energy subsidies under the SCM regime.[108]

Although the Appellate Body's legal reasoning was described as "legal acrobatics" to avoid finding that a climate support scheme constituted a prohibited subsidy,[109] the evolutionary approach employed in the Appellate Body's legal analysis was not without any legal support. Previous cases also supported an evolutionary interpretation of the WTO agreements. In justifying that turtles could be defined as "exhaustible natural resources," the Appellate Body stated that:

> The words of Article XX(g), "exhaustible natural resources", were actually crafted more than 50 years ago. They must be read by a treaty interpreter in the light of contemporary concerns of the community of nations about the protection and conservation of the environment.[110]

Such an approach was also supported by principles of interpretation of treaties contained in the VCLT. The VCLT instructs that the interpretation of a treaty shall take into consideration "any relevant rules of international law applicable in the relations between the parties."[111] As there is great overlap of membership between the WTO and the UNFCCC, the obligations made under the UNFCCC should be viewed as relevant for the interpretation of the SCM Agreement.

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[103]Howse, *supra* note 101, at 6.

[104]Howse, *supra* note 101, at 5.

[105]Avidan and Jha, *supra* note 30, at 265.

[106]*Id*.

[107]*See* Alan O. Sykes, *The Questionable Case for Subsidies Regulation: A Comparative Perspective*, 2.2 J. L. Analysis 473 (2010).

[108]Shadikhodjaev, *supra* note 1, at 874.

[109]Cosbey and Mavroidis, *supra* note 17, at 12.

[110]Shrimp/Turtle, 129.

[111]*See* Article 31(3)(b) of the Vienna Convention on the Law of Treaties (May 23, 1969).

6 Implications

The *Canada – FIT* case was the first time that the WTO Appellate Body addressed the ongoing climate – trade conundrum in the context of renewable energy. It was held that the domestic content requirement of the Ontario FIT program violated the national treatment doctrine, but the Appellate Body did not conclude whether the FIT program constituted prohibited subsidies under the SCM Agreement. At the heart of the Appellate Body's reasoning was that there is a separate benchmark market for renewable energy than the conventional energy market. The unconventional benefit analysis in the *Canada – FIT* report indicated that the WTO Appellate Body rose to challenge of climate change by attempting to reconcile the climate support subsidies with the restrictive disciplines under the SCM Agreement.

Trade watchers predict that the Appellate Body's legal reasoning in the *Canada – FIT* case will provide a shelter for green industrial policies from WTO's restrictive scrutiny of subsidies. While it takes more trade disputes to verify the validity of this claim, countries have already responded to the *Canada – FIT* jurisprudence by dropping subsidy claims in their request for consultation and request for establishing a panel concerning the domestic content requirement for India's National Solar Mission.[112] Accordingly, the Panel in *India – Solar Cells* does not address the subsidy issue,[113] as the panel request defines the scope of the dispute and serves to establish and delimit the panel's jurisdiction.[114]

The *India – Solar Cells* was the second case where the WTO addressed the issue of climate change and renewable energy. The Panel in *India – Solar Cells* ruled against India, holding that the domestic content requirement of India's National Solar Mission violated the national treatment obligation under the GATT and the TRIMs. The absence of subsidy claims in the Panel Report, however, was quite conspicuous. In initiating proceedings at the WTO dispute settlement body, member states responded to the activist WTO jurisprudence by strategically modifying their claims. The United States included claims under the SCM Agreement in its first consultation request, but withdrew the SCM claims in their second consultation request after the *Canada – FIT* Appellate ruling came out.[115] So far, the judicially created shelter defers to the sovereign defendants' unilateral climate subsidies except outright discriminatory measures such as domestic content requirement. In a time when national governments fail to reach a consensus on how to collectively address the challenge of climate change, the WTO jurisprudence on renewable

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[112] Marc Benitah, *India-Solar Cells: The Strange Absence of The SCM in the US Claim, International Economic Law and Policy Blog* (Feb. 29, 2016, 10:26 AM), http://worldtradelaw.typepad.com/ielpblog/2016/02/india-solar-cells.html.

[113] Panel Report, *India—Certain Measures Relating to Solar Cells and Solar Modules*, WT/DS456/R (Feb.22, 2016).

[114] *See* Appellate Body Report, *Argentina—Measures Affecting the Importation of Goods*, WT/DS438/AB/R, WT/DS444/AB/R, WT/DS445/AB/R, (Jan. 15, 2015) (adopted Jan. 26, 2015).

[115] *See* Asmelash, *supra* note 27.

energy that puts the restrictive subsidy analysis aside should be a boon to national efforts in developing renewable energy and mitigating climate change.

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Chapter 16
Export Restraints of Natural Resources and the SCM Agreement

Jaemin Lee

Abstract Exports restraints have raised controversies recently due to the importance of the natural resources and the scarcity of them. The core aspect of the export restraints can ultimately lead to the claims and disputes over subsidy issues under the WTO's *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"). Based on prevailing jurisprudence of the subsidy norms, an argument can be made that certain types of export restraints are found to satisfy the elements of a subsidy within the meaning of the SCM Agreement. It can be shown that these export restraints constitute financial contribution by the government that confer benefit on the recipient companies which are specific to certain confined industries. All the unique aspects of the export restraints programs should be put under careful scrutiny of the collective discussions of the international community including the analyses under the SCM Agreement. Export restraints should be adopted and applied in a manner consistent with the applicable WTO Agreements including, most notably, the SCM Agreement.

Keywords Export restraints • Export restriction • Natural resources • Market distortion • Prohibited subsidy • Indirect subsidy • SCM agreement

1 Introduction

The WTO's *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") plays an important role in ensuring a level playing field in international trade. The agreement captures illegal subsidization practices of WTO Members that have distorting effects on global trade by injuring other Members and their traders. Over the years, the number of trade disputes involving subsidies has been in steady increase, and at the same time subsidy disputes are becoming ever more complex in many respects. In the meantime, the fact that the agreement virtually turns a blind eye to the legitimacy of governmental policies, as it currently stands, has also drawn increasing criticism as well. For instance, the SCM Agreement does not contain a general exceptions clause as found

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_16

in Article XX of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") or something equivalent to such a provision. Nor does Article XX of GATT 1994 apply to this agreement either under the prevailing jurisprudence. As a consequence, any governmental program affecting the trade remains subject to the SCM Agreement even if the underlying policy objectives are somehow legitimate and appropriate.

This framework also applies to governmental programs regulating the trade of natural resources. There may be a wide range of governmental objectives behind these programs. The propriety of the governmental purposes notwithstanding, if such programs satisfy the elements of a subsidy within the meaning of the SCM Agreement, they remain subject to the agreement. Now, WTO Members' measure regulating the trade of natural resources are getting increasing global attention and inviting fierce disputes. This reflects the reality that such natural resources – raw materials and rare earths, in particular – are in short supply globally,[1] and that these natural resources are key ingredients for the manufacture of modern electronic devices such as LCD, radars, GPS, batteries, and mobile phones.[2] Not surprisingly, these materials are also in great demand for military purposes as well.[3] Given the

[1]Panel Reports, *China-Measures Related to the Exportation of Rare Earths*, *Tungsten and Molybdenum*, WT/DS431/R, WT/DS432/R, WT/DS433/R (Mar 26, 2014) ("*China-Rare Earths*"), at para. 7.367; Nawshad Haque, Anthony Hughes, Seng Lim & Chris Vernon, *Rare Earth Elements*: *Overview of Mining*, *Mineralogy*, *Uses*, *Sustainability and Environmental Impact*; Ann Norman, Xinyuan Zou & Joe Barnett, *Critical Minerals*: *Rare Earths and the U.S. Economy*, National Center For Policy Analysis (Sep 2014); Bradley S. Van Gosen, Philip L. Verplanck, Keith R. Long, Joseph Gambogi & Robert R. Seal, II, *The Rare-Earth Elements – Vital to Modern Technologies and Lifestyles*, USGS Mineral Resources Program, U.S. Department of the Interior, U.S. Geological Survey Fact Sheet 2014–3078 (Nov 2014), at 4; Julia Ebner, *Europe*'*s Rare Earth Dependence on China Future Perspectives*, European Institute for Asian Studies (Dec 2014), EIAS Briefing Paper 2014, at 5–6; Bernd Lehmann, *Economic geology of rare-earth elements in 2014*: *a global perspective*, European Geologist (May 2014), at 24; Natalie Greve, *Tungsten*, *Tantalum*, *Rare Earths Emerging As* '*Critical*' *Global Metals*, Creamer Media's Mining Weekly (July 3, 2013).

[2]*See* U.S. First Written Submission submitted in *China-Rare Earths*, at para. 7 (available at the USTR website at www.ustr.gov visited on Apr 14, 2016); Bradley S. Van Gosen et al., *The Rare-Earth Elements – Vital to Modern Technologies and Lifestyles*, U.S. Department of the Interior, U.S. Geological Survey Fact Sheet 2014–3078 (Nov 2014), at 1; Ann Norman, Xinyuan Zou & Joe Barnett, *Critical Minerals*: *Rare Earths and the U.S. Economy*, at 1; Christopher Blakely et al., *Rare Earth Metals & China*, at 2–4; Nicholas Jepson, *A 21st Century Scramble*: *South Africa*, *China and the Rare Earth Metals Industry*, South African Institute of International Affairs (2012), at 6–7; John Prendergast & Sasha Lezhnev, *From Mine to Mobile Phone The Conflict Minerals Supply Chain*; Bernd Lehmann, *Economic geology of rare-earth elements in 2014*: *a global perspective,* European Geologist (May 2014), at 21-22; Päivi Pöyhönen & Eeva Simola, *Connecting Components*, *Dividing Communities Tin Production for Consumer Electronics in the DR Congo and Indonesia*, Finn Watch (Dec 2007); John A. Shields, *Applications of Molybdenum Metal and its Alloys*, International Molybdenum Association (2013, London), at 39.

[3]*See* Christopher Blakely et al., *Rare Earth Metals & China*, at 4; Charles J. Butler, *Rare Earth Elements*: *China*'*s Monopoly and Implications for U.S. National Security*, the Fletcher Forum of World Affairs, vol.38:1 (winter 2014), at 26; Jesse Salazar, *Securing Rare Earth*: *Leveraging U.S. Drug Policy for Technological Advantage*, Yale Journal of International Affairs, Vol. 6, 2011, at 127; Marc Humphries, *Rare Earth Elements*: *The Global Supply Chain*, Congressional Research

scarcity of the natural resources, it is hard to imagine, practically speaking, that a WTO Member imposes an import restriction. On the other hand, an export restriction would cause a prompt controversy, as domestic suppliers of these modern products stand to benefit from the stable supply of natural resources while their foreign competitors are unable to have access to the resources or are rendered more difficult to secure the access to such resources. Arguably, such disparity between domestic manufacturers and foreign competitors would lead to claims of violation of covered agreements. Among these, this article aims to look into the export restraints of natural resources of a Member from the angle of the SCM Agreement.

2 An Overview of China-Raw Materials and China-Rare Earths

Two recent WTO disputes addressed the issue of export restraints of natural resources. These disputes involve China's export restraints of its own natural resources for various policy reasons. They are *China – Measures Related to the Exportation of Various Raw Materials*,[4] where the European Union, the United States and Mexico challenged the Chinese measure under GATT 1994 and China's Accession Protocol, and *China – Measures Related to the Exportation of Rare Earths Tungsten and Molybdenum*,[5] where the European Union, the United States and Japan were the complainants against a similar Chinese measure under the GATT 1994 and the Accession Protocol, respectively.

In *China-Raw Materials*, the complainants challenged export restraints imposed by China regarding the exportation of nine raw materials. The nine raw materials are Bauxite, Coke, Fluorspar, Magnesium, Manganese, Silicon Metal, Silicon Carbide, Yellow Phosphorus and Zinc. These nine raw materials are used for the production of steel, aluminum and various chemicals, and are therefore considered to be essential to the manufacture of various industrial products.[6] According to the complainants, the export restraints imposed by China take the forms of (i) export quotas, (ii) export duties, (iii) export licenses, and (iv) minimum export pricing requirements.[7] The complainants argued that these restraints constituted a violation

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Service, 2010, at 2, available at, http://medallionresources.com/wp-content/uploads/2012/08/Congressionnal-Report-July2010.pdf Accessed on Apr 15, 2016; Nicholas Sanders, *A Response to Ryan P. Carpenter's "The Bottom of the Smart Weapon Production Chain: Securing the Supply of Rare Earth Elements for the U.S. Military"*, Public Contract Law Journal Vol. 41, No.4, Summer 2012, at 958.

[4] *See* Appellate Body Reports, *China-Measures Related to the Exportation of Various Raw Materials*, WT/DS394, 395, 398/AB/R (adopted on Feb 22, 2012) ("*China-Raw Materials*").

[5] *See* Appellate Body Reports, *China-Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum*, WT/DS431, 432, 433/AB/R (adopted on Aug 29, 2014) ("*China-Rare Earths*").

[6] *See* U.S. First Written Submission submitted in *China-Raw Materials*, at para. 4.

[7] *See* Panel Reports, *China-Raw Materials*, at para. 2.1.

of various provisions of the GATT 1994, the Accession Protocol and the Working Party Report attached to the protocol.[8] As to all of the four claims, the panel and the Appellate Body ruled for the complainants by finding them in violation of the WTO Agreements.[9] In January 2013 China informed the Dispute Settlement Body ("DSB") of its implementation of the rulings and recommendations of the DSB by having removed the challenged measures and introduced a new regulation.[10] Upon this notification, the disputes have been resolved.

In *China-Rare Earths*, the complainants challenged export restraints imposed by China regarding the exportation of rare earths, tungsten, and molybdenum as violating relevant provisions of the GATT 1994, the Accession Protocol and the Working Party Report.[11] Because of their unique physical qualities, rare earths are said to be key inputs for many industrial products including magnets in motors, generators, and hard disk drives.[12] According to the complainants, the export restraints and restrictions imposed by China took the forms of (i) export quotas, (ii) export duties, and (iii) export licences.[13] The complainants argued that these restraints and restrictions constituted a violation of relevant provisions of the GATT 1994, the Accession Protocol and the Working Party Report[14] and the panel and the Appellate Body also basically agreed to the claimants' arguments. Afterwards, in May 2015 China informed the DSB of its implementation of the rulings and recommendations of the DSB. Upon this notification, the complaining Members did not pursue a compliance dispute.[15]

These two disputes present important legal implications. They offer a guidance as to an outer parameter of a Member's legitimate authority in formulating and administering its policies regarding natural resources in its territory. In particular, these two disputes raise an important issue of how a WTO Member can exercise its right to regulate the exportation of its natural resources in a WTO consistent manner. In addition, from the perspective of business, they also carry a significant impact on the global market of natural resources since China dominates the supply of these resources in the global market.[16] More specifically, note should be taken of

[8] *See id.*, at paras. 3.2–3.4.

[9] In Feb 2012, the Dispute Settlement Body ("DSB") adopted its recommendations and rulings in the dispute, concluding that the restrictions at issue were inconsistent with China's WTO obligations. *See* Appellate Body Reports, *China – Raw Materials*, Panel Reports, *China – Raw Materials*.

[10] *See* the World Trade Organization, Summary of the Disputes, available at https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds394_e.htm (last visited on Apr 10, 2016).

[11] *See* Panel Reports, *China-Rare Earths*, at para. 3.1.

[12] *See id.*, at paras. 2.5–2.7.

[13] *See id.*, at para. 2.8.

[14] *See id.*, at para. 3.1.

[15] *See* the World Trade Organization, Summary of the Disputes, available at https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds431_e.htma (last visited on Apr 10, 2016).

[16] U.S. First Written Submission submitted in *China-Rare Earths*, at para. 7.

the argument of the complaining Members in terms of practical impact on international trade, that is, the global scarcity and higher prices stemming from the result of the export restraints.[17] It has been argued that companies in other countries have had to suffer from the challenged measures while the Chinese companies have enjoyed easier access to the natural resources.[18] If this allegation holds true, this would distort the competition in the global markets of merchandise using these natural resources as key ingredients, namely electronics or steel industries.

This article aims to address whether the export restraints and restriction can amount to a measure that constitutes a violation under the SCM Agreement. As noted above, subsidy issues have not been discussed in *China-Raw Materials* or *China-Rare Earths* as the key issues raised in the disputes were Articles XI and XX of GATT 1994, and relevant paragraphs of the Accession Protocol of China and the attendant Working Party Report. What was missing in the discussion of the disputes was the references made by business entities and competitors regarding the challenged export restraints. They claimed that the underlying purpose of the measures was to provide a business environment where Chinese companies can have easier access to the key industrial materials so as to enhance their competiveness edge in the global competition.[19] This assertion is closely related to the subsidy allegation under the SCM Agreement, as the assertion involves a governmental measure that supports, albeit indirectly, export activities of domestic producers. To the extent that governmental support is provided to a private industry and companies, these export restraints would inevitably implicate various provisions of the SCM Agreement under the WTO regime. Therefore, it appears critical that the Members should be apprised of the jurisprudence of the SCM Agreement in the course of analyzing the export restraints at this juncture so as to attain a full picture of the situation.

As a matter of fact, in this dispute, the complainants described, although indirectly, export restraints at issue from the perspective of subsidy issue. They portrayed the measures as an industrial policy designed to "provide a competitive advantage to downstream industries located in China; and induce downstream producers in other WTO Members to cease production or move to China in order to secure access to supplies of the material."[20] They further argue that this is the resurrection of "beggar-thy-neighbor" policy.[21] These statements, in their essence, resemble subsidy allegations involving ordinary industrial subsidies.

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[17]*Id*. at para. 8.

[18]*Ibid*.

[19]*Ibid*.

[20]*See id*., paras. 1, 8, and 29–30.

[21]*See id*.

3 Jurisprudence of the SCM Agreement

According to the SCM Agreement, the definition of a subsidy is "a financial contribution by a government body (Article 1.1(a)) that confers a benefit (Article 1.1(b)) to a specific enterprise or industry (Article 2)." In other words, a subsidy to be regulated under the SCM Agreement means something of financial value that has been conferred by a government on selected companies and favored industries. These subsidies are then subject to a penalty, either in the form of countervailing measures[22] or through direct legal action at the WTO,[23] depending upon other additional requirements are satisfied. The rationale behind penalizing subsidies is that a government's subsidization of a company artificially allows the company to enjoy competitive advantage in the international market, which hinders a fair competition in a free market. As such, under the WTO regime, a subsidy, just like a dumping, constitutes an "unfair trade." The purpose of these countermeasures is understood to "level the playing field."

Importantly, at the same time, the SCM Agreement is mindful not to interfere with the Members' governments' inherent authority to pursue legitimate public objectives and economic policies within the parameters of various provisions of the agreement, as it is affirmed by the panel in *Canada–Aircraft*.[24] Subsidy issues or disputes raise controversies as to the proper bounds of national economic policies.[25] An argument can be made that in some instances export restraints play a central role in the national economic development, preservation of natural resources or conservation of the environment, and that they thus are closely related to the pursuit of legitimate public policies of various kinds. Consequently, export restraints of natural resources arguably deserve and require a careful scrutiny under the SCM Agreement: the nature, objectives, and operation schemes of the export restraints should be carefully examined and the SCM Agreement should not unduly restrict the authority of a government in carrying out its important socio-economic function.

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[22] *See* SCM Agreement, Part V.

[23] *See id*., Part III.

[24] Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (Aug 20, 1999), at para. 9.119.

[25] *See* Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R (Jan 19, 2004) ("*US-Softwood Lumber* IV"), at para. 52; Panel Report, *United States – Measures Treating Exports Restraints as Subsidies*, WT/DS194/R (June 29, 2001), at para. 8.65:

> … 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.

3.1 Elements of a Subsidy

According to the SCM Agreement, for there to be a subsidy, three elements are required. They are (i) financial contribution by the government,[26] (ii) benefit,[27] and (iii) specificity.[28] Confirming the existence of the three elements is the starting point for any subsidy discussion and regulation. If one of the elements is missing, then it means an absence of a subsidy in the first place for the purpose of the SCM Agreement. It follows then no penalty or countermeasure can be contemplated. The three elements are discussed below respectively.

3.1.1 Financial Contribution by a Government

This is the requirement that money or its equivalent must be transferred from the government account to a private entity's account. In other words, money or something equivalent to money should change hands from the government to a company. The SCM Agreement provides four basic categories of how this transfer can take place. While the four categories are set forth in the SCM Agreement, it should be noted that the jurisprudence of the SCM Agreement has interpreted the four categories in a broad manner. So, as long as core elements of a measure follows the traits of any enumerated category, the measure is deemed to fall under the category. In addition, possibly as a result of a rather broad interpretation of categories, a measure can fall under the multiple categories at the same time.

(a) Direct transfer of funds[29]

The most common example of this category of direct transfer of funds is when the government provides a grant to a company or companies in an industry. A grant is monetary support provided by the government without any conditions attached. Likewise, a loan from a government-owned bank or loan guarantee from the government for the benefit of a private entity is also generally regarded as falling under this category. Equity infusion, in which a government agency purchases equities of private companies to provide financial support for an ailing company, is also regarded as falling under this category as the government money is transferred from the government treasury to the private entity through this transaction.

(b) Foregoing or not collecting governmental revenues[30]

This is a situation where a government provides tax credits and exemptions for the benefit of a private entity. The reduced or exempted amount by the government

[26]*See* SCM Agreement, Article 1.1(a)(1).

[27]*See id*., Article 1.2.

[28]*See id*., Article 2.

[29]*See id*., Article 1.1(a)(1)(i).

[30]*See id*., Article 1.1(a)(1)(ii).

also constitutes a form of financial contribution from the government in the amount reduced or exempted as such. Tax exemption is usually provided in the general tax law of a state. Similarly, when import duty is reduced or exempted, or any other form of governmental fee is reduced or exempted, this is also treated in the same manner.

(c) Provision of goods or services[31]

The third category concerns a situation where a government provides goods or services for free or receives payment in return which is less than the total value of such goods and services thus provided.[32] Here, however, provision of general infrastructure (such as building a port or an industrial complex) by the government is not covered by this provision, as this is usually done for the general economic policy objectives. Thus, general infrastructure establishment is not counted as a financial contribution by the government, hence no subsidy, even if some companies and industries receive benefit from such infrastructure. What is also covered by this category is the purchase of goods. A government agency purchases goods and pays a price higher than a market price, then financial contribution of this category exists in the amount of such price differences. It is noteworthy that it is only "purchase of goods," not "purchase of services." The term "purchase of services" does not appear in the text of this provision.

(d) Entrustment or direction of a private entity[33]

This last category of financial contribution is sometimes called "indirect subsidy." This usually happens when the government forces an unwilling private entity to do something for the benefit of yet another private entity. For instance, if the government forces a bank to extend a loan to a private company, this provision is implicated and financial contribution by a government is also confirmed. This indirect subsidy category is rather vague and fact-specific, so that alleging and proving such claims can be sometimes complex and controversial: in this instance, an overly expansive reading of this provision and a loose recognition of such situation might lead to arguments of the infringement of national economic sovereignty of a WTO Member.[34]

[31]*See id*., Article 1.1(a)(1)(iii).

[32]For instance, this happens when the government provides $100 worth of governmental service and receives only $50 in return. Financial contribution occurs in the amount of $50 ($100–$50) in the case.

[33]*See* SCM Agreement, Article 1.1(a)(1)(iv).

[34]*See Appellate Body Report*, *United States – Countervailing Duty Investigation on DRAMs from Korea*, WT/DS296/AB/R (July 20, 2005) ("*U.S.-DRAMs*"), at paras. 108–116.

3.1.2 Benefit

The second element of a subsidy is the existence of benefit. According to Articles 1.2 and 14 of the SCM Agreement, a subsidy is only found when a benefit is conferred on the private entity as a result of financial contribution by the government. In other words, even if there is financial contribution from the government through one of the four categories identified above, if there is no benefit conferred from the transaction, then there is no subsidy under the SCM Agreement. For there to be a subsidy under the SCM Agreement, there must be benefit *for the recipient* of the governmental assistance as a result of the financial contribution.[35] As a result of the governmental support from its own government the recipient companies and industries have now become "better off" than before or than they would otherwise be. This "better-off" situation is the critical threshold in terms of the application of Articles 1.2 and 14 of the SCM Agreement.[36]

For example, the moment a government-owned bank provides a loan, there is financial contribution by the government as it falls under the first category mentioned above. However, if the applicable interest rate for the loan is the same as or higher than the prevailing market rate, there is no benefit conferred from the transaction. Thus, as the second element is missing, there does not exist a subsidy within the meaning of the SCM Agreement. Benefit is calculated by comparing the company's current situation with the alleged subsidy and the situation that the company would be in without the alleged subsidy. Therefore, in the case of a "grant," the entire amount would become the amount of the benefit. In the case of a preferential loan with a low interest, the benefit would be the difference between the viable market interest rate and the alleged low interest rate.

3.1.3 Specificity

The third element for a subsidy is the concept called "specificity." According to Article 2 of the SCM Agreement, financial contribution by a government that confers a benefit only becomes a subsidy if it is "specific" to a company, an industry, a group of companies, or a group of industries. The inquiry of how specific is specific enough requires basically a case-by-case determination instead of a bright-line test. There are two types of specificity in this regard: one is *de jure* specificity and the other is *de facto* specificity. Either of them constitutes specificity for the purpose of Article 2 of the SCM Agreement. *De jure* specificity is found to exist when a statute or regulation explicitly limits, in the texts, the scope of recipients to certain groups or industries. In other words, the law or regulation itself indicates that the provision of subsidy at issue is confined to certain industries and

[35] *See* SCM Agreement, Article 1.1(b).

[36] *See* Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (Aug 20, 1999) ("*Canada-Aircraft*"), at para. 157.

companies. On the other hand, *de facto* specificity is instead found when a disproportionate amount of benefit goes to a particular industry or industries from a program even if the statute or regulation administering the program are neutral on its face. Whereas the texts of laws and regulations do not refer to confinement, the record of provision accumulated over a long period of time shows that certain industries and companies have received a disproportionate amount of support.

Two types of subsidies are legally designated as specific. They are export subsidies[37] and import substitution subsidies.[38] These two subsidies are considered to cause severe distortion to international trade, and as such their existence, by definition, is regarded as specific.

4 Export Restraints Under the SCM Agreement Jurisprudence

Based on the elements of a subsidy under the SCM Agreement as discussed in the previous chapter, this chapter looks into whether export restraints as they stand at present implicate the SCM Agreement and whether the three elements of a subsidy can be satisfied. Since "export restraints" is a generic term, they can take many different forms. So, it would not be appropriate, nor accurate, to state, in general terms, that export restraints are subsidies or they are not subsidies. The final disposition would be dependent upon how a particular export restraint program is formulated and administered. So, a general description of a subsidy as regards export restraints would be neither appropriate nor accurate. Nonetheless, a subsidy discussion for export restraints would be still meaningful as it could at least provide a general contour of the measure from the subsidy angle. Detailed analyses for specific programs may then be adjusted depending on how the contents of the programs are determined.

In addition, to be precise, the existence of a subsidy as a result of showing the satisfaction of the three elements above does not mean that the subsidy will then be subject to regulation under the SCM Agreement. One additional outside economic factor is required. In the case of direct subsidy litigation in the WTO dispute settlement proceeding, a complainant should show the existence of adverse effects as a result of the subsidy program at issue.[39] As regards countervailing duty investigation, the investigating authority should show the existence of material injury to the domestic industry as a result of the import of the subsidized imports.[40] These two indicators concern the overall business performance of the domestic industry of the other parties affected by the subsidization at issue, in the domestic

[37]*See* SCM Agreement, Article 3.1.

[38]*See id*., Article 3.2.

[39]*See id*., Articles 5 and 6.

[40]*See id*., Article 15.

market or in the global market as the case may be. As it is difficult to assess or predict, in advance, how an individual industry in a country would fare in the face of subsidization by other countries, an inquiry into this question could only be meaningfully conducted once an actual dispute is raised as regards a particular industry or a particular company at a particular point in time.

That said, an analysis of whether a particular governmental program has the possibility of constituting a subsidy within the meaning of the SCM Agreement is still useful and sometimes important, since such advance analyses would show whether the program at issue is indeed a subsidy, legally speaking, in the first place. The recognition that a program is likely to become a subsidy under the SCM Agreement is quite telling in and of itself. It may then indicate that subsidy disputes loom over the horizon in the long run if competing industries in other countries are harmed in their respective domestic markets or in the global market. So, in sectors where fierce global competition is observed, it will be arguably a matter of time before subsidy disputes are presented.

4.1 Some Factual Background

The fierce global competition over the natural resources stems from the fact that these materials are not generally available and are deposited only in a few countries.[41] By way of example, those with largest deposits of rare earths are as follows[42]: China accounting for 50 % of the global deposits, Russia and other Commonwealth of Independent States 17 %, the United States 11.8 %, India 2.8 %, and Australia 1.45 %. And not only the amount of the deposits, in terms of the production China currently produces around 97 % of the global supply of rare earths.[43]

In the case of Tungsten[44]: China accounting for 65.5 % of the global deposit, followed by Russia with 8.6 %, the United States with 4.8 %, Canada with 4.1 %. As regards the amount of domestic reserves of Molybdenum: China reserves 4,300,000 metric tons, followed by the United States with 2,700,000 metric tons, Chile with 1,200,000 metric tons, and Peru with 450,000 metric tons, respectively. So, the disparity among states in terms of the amount of deposits stands stark.

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[41]Richard Silberglitt, James T. Bartis, Brian G. Chow, David L. An & Kyle Brady, *Critical Materials Present Danger to U.S. Manufacturing*, National Defense Research Institute, at 17; Christopher Blakely et al., *Rare Earth Metals & China*, at 3; Julia Ebner, *Europe's Rare Earth Dependence on China Future Perspectives*, at 4.

[42]Christopher Blakely et al., *Rare Earth Metals & China*, at 3.

[43]Renewable Energy Policy Network for the 21st Century, Renewables 2011: Global Status Report (2011), at 42, available at, http://germanwatch.org/klima/gsr2011.pdf, Accessed on Apr 15, 2016.

[44]Richard Silberglitt et al., *Critical Materials Present Danger to U.S. Manufacturing*, National Defense Research Institute, at 17.

Given such conspicuous disparity, if some states purport to adopt governmental measures that help develop and assign these natural resources for the benefit of their domestic industries so that they can enhance their competitive advantage in the global market, other countries criticism is bound to intensify.[45] It has been alleged that some countries have been pursuing this line of policy one way or another.[46] Export restraints are one of the typical measures adopted in this respect.[47] Export restraints tend to provide an immediate benefit to the companies that heavily rely on the stable supply of these natural resources.[48] To these companies, in terms of business performance, none would be more beneficial than ensuring the stable access to the key natural resources for the manufacture of their products.[49] On the other hand, companies in other countries have had difficulty in competing with the companies from the states with large deposits of natural resources with export restraints in place.[50] An apparently direct impact on the business performance of companies in the market has led to the growing attention by the governments of these companies and to intensifying controversies and disputes among WTO Members.[51] It is against this backdrop that discussions on the SCM Agreement jurisprudence are presented.

Based on a brief overview of the key provisions and jurisprudence of the SCM Agreement in the previous chapter, this chapter aims to analyze the export restraints programs from the angle of the SCM Agreement. As noted above, in previous disputes involving exports restraints of natural resources, the focus of the analyses were GATT 1994 and Accession Protocols, if applicable. Analyses from the subsidy angle have not been conducted so far. Given the apparent benefit for the domestic industries and presumed support for exporting industries coupled with

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[45]Mirko Woitzik, *Pure Business, Law Enforcement or Sheer Politics? The EU's WTO Complaints against Chinese Export Restrictions on Raw Materials*, College of Europe, Department of EU International Relations and Diplomacy Studies (June 2013), at 3; Christopher Blakely et al., *Rare Earth Metals & China*, at 9.

[46]*See* U.S. First Written Submission submitted in *China-Rare Earths*, para. 26; Christopher Blakely et al., *Rare Earth Metals & China*, at 11–12; Wayne M. Morrison & Rachel Tang, *China's Rare Earth Industry and Export Regime: Economic and Trade Implications for the United States*, Congressional Research Service (Apr 30, 2012), at 26.

[47]*See* U.S. First Written Submission submitted at *China-Rare Earths*, at para. 27; Mirko Woitzik, *Pure Business, Law Enforcement or Sheer Politics?*, at 3.

[48]*See* U.S. First Written Submission submitted at *China-Rare Earths*, at para. 27; Wayne M. Morrison & Rachel Tang, *China's Rare Earth Industry and Export Regime: Economic and Trade Implications for the United States*, Congressional Research Service (April 30, 2012), at 29.

[49]*See* U.S. First Written Submission submitted at *China-Rare Earths*, at para. 27; David L. An, *Critical Rare Earths, National Security, and U.S.-China Interactions*, A Portfolio Approach to Dysprosium Policy Design, Pardee RAND Graduate School, at 19 and 27; Nicholas Jepson, *A 21st Century Scramble*, at 18.

[50]*See* U.S. First Written Submission submitted at *China-Rare Earths*, at paras. 28–29; David L. An, *Critical Rare Earths, National Security, and U.S.-China Interactions*, at 20; Julia Ebner, *Europe's Rare Earth Dependence on China Future Perspectives*, at 4.

[51]Nicholas Jepson, *A 21st Century Scramble*, at 29; Colonel Charles J. Butler, *Rare Earth Elements*, at 31.

harmful effect for foreign competitors in the global market, attention needs to be drawn to the subsidy aspect of export restraints. Previous subsidy disputes at the WTO dispute settlement proceedings have indeed addressed a wide range of different governmental support measures for domestic industries. In particular, recent subsidy disputes have dealt with situations where governmental support is provided in an indirect manner, even if outright provision of monetary resources is not present. The gist of the subsidy discussion, therefore, has been whether a governmental measure is designed to provide money, goods or services to their domestic manufacturers for free or at cheaper prices, and whether the recipients are able to enhance their competitiveness in the global market. Bearing this in mind, this chapter discusses the issue of financial contribution, benefit and specificity under the SCM Agreement to gauge the overall subsidy implication of export restraints programs. As seen below, an argument can be made that these programs are generally deemed to satisfy the three requirements of a subsidy under the agreement, thus leading to the finding of existence of a subsidy.

It should be noted that an argument for a national sovereignty can be raised in this respect. As a matter of fact, when export restraints and control measures are adopted, sometimes it is stated that official reasons for imposing export restraints are the conservation of natural resources.[52] As conservation or utilization policies of national resources constitute a core of national sovereignty, a question can be raised as to whether this aspect can provide a defense for a possible violation of the WTO Agreements.[53] Other principles of international law and provisions in treaties can be presented as well.[54] However, any defense to a possible violation of the WTO Agreements should be found within the framework of the WTO Agreements as stipulated in Article 3.2 of the *Dispute Settlement Understanding*. An attempt to rely on extra-WTO Agreements principles (except for the application of the general principles of treaty interpretation and possibly rules of state responsibility) have been consistently defeated by the reviewing panels and the Appellate Body. So, a possible defense to an allegation of violation of the WTO Agreements including the SCM Agreement should be found within the agreements themselves. In the case of the SCM Agreement, unlike the GATT 1994 even a general exceptions clause does not exist at present.

Over the years, (industrial) subsidy disputes have raised the difficult question of delineating a fine line between legitimate governmental economic policies and the illegal (indirect) subsidization measures.[55] The inherent difficulty would become

[52]*See* Panel Reports, *China-Rare Earths*, at para. 7.252; David L. An, *Critical Rare Earths, National Security, and U.S.-China Interactions*, at 32; Government of the People's Republic of China (2012), *Situation and Policies of China's Rare Earth Industry*, Information Office of the State Council (Beijing: Foreign Language Press, June 2012).

[53]*See* Panel Reports, *China-Rare Earths*, at para. 7.252; China's First Written Submission, para. 55.

[54]China's First Written Submission, para. 56.

[55]Appellate Body Report, *U.S.-Softwood Lumber IV*, at para. 52; Panel Report, *United States – Measures Treating Exports Restraints as Subsidies*, WT/DS194/R (June 29, 2001), at para. 8.65.

more acute in the highly sensitive and politically charged areas of agricultural or fisheries sectors. As such, it may be prudent for Members to contemplate on the possibility of introducing a general exceptions clause even in the context of fisheries subsidies regulation. Existence of the general exceptions clauses in the GATT 1994 and GATS offers convincing rationale for the inclusion of a similar provision in a more politically sensitive area of fisheries subsidies norms. It is also necessary, of course, to include provisions that can deter abuse of such an exceptions clause.

4.2 *Elements of a Subsidy*

Whether an export restraints program can be considered a subsidy within the meaning of the SCM Agreement is discussed in the following section. Each element of a subsidy is discussed one by one. Again, as export restraints programs could vary significantly, it would be too broad a statement to generally characterize them as subsidies. Rather, the analyses below are mainly based on export restraints as raised and discussed in the previous two disputes at the WTO dispute settlement proceedings. As discussed below, it may be the case that export restraints, as reviewed in the recent disputes, are found to satisfy the three elements of a subsidy if key arguments and assertions are supported by factual evidence.

4.2.1 Financial Contribution Analysis

The first prong of a subsidy analysis under the SCM Agreement, which is financial contribution by the government, is interpreted as requiring an inquiry whether money or something equivalent to money has been transferred from the government to a private recipient. Provision of an actual cash grant is just one form of providing financial contribution.[56] There are many other forms of providing financial

("... 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"); 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); Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (Mar 25, 2011) ("*U.S.-AD/CVD*"). Indirect subsidization measures have been raised and examined in Appellate Body Report, *U.S.-DRAMs*; Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea*, WT/DS296/R (Aug 3, 2005); Appellate Body Report, *Japan-Countervailing Duties on Dynamic Random Access Memories from Korea*, WT/DS336/AB/R (Dec 17, 2007); Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS 273/R (Apr 11, 2005).

[56]See SCM Agreement, Article 1.1(a)(1)(i)

contribution to private entities under the SCM Agreement.[57] As long as private entities receive something with monetary value from their government, this prong is then satisfied.

Viewed from this perspective, the requisite analysis with respect to export restraints of natural recourses of a WTO Member should start by looking into whether the measure at issue has transferred something with monetary value to domestic corporations. The complainants' arguments in *China-Raw Materials* and *China-Rare Earths* are that these export restraints have caused an effect of driving down the price for these key natural resources for domestic consumers, who are largely exporters of industrial products using these resources.[58] On the other hand, the scarcity of natural resources outside the responding Member resulting from the export restraints, the complainants argued, have increased the price of these resources for foreign companies in the global markets.[59] Assuming that the price reduction effect for domestic manufacturers and the price increase effect for foreign competitions are proven by factual evidence, the export restraints may arguably constitute the third category of financial contribution under Article 1.1(a)(1)(iii) of the SCM Agreement, which is governmental "provision of goods or services." The natural resources such as rare earths, tungsten and molybdenum are goods with respective HS code numbers,[60] and the amount of resources corresponding to the amount of price reduction can be regarded as provided "for free" by the government. The amount of reduction can be calculated by comparing the price of natural resources in the domestic market where export restraints are in force with the price of a competitive global market in the absence of the measure. An argument can be made that the natural resources as goods have been provided by the government to the domestic manufacturers, which then would satisfy the third category of financial contribution under Article 1.1(a)(1)(iii) of the SCM Agreement.

Alternatively, it can also be argued that export restraints constitute "direct transfer of funds" under Article 1.1(a)(1)(i) of the SCM Agreement to the extent that domestic manufactures end up paying less than the amount to be charged in a competitive market (either domestic market or a global one) in the absence of such measures. They now pay a lower price for the inputs they purchase for the production of final goods for export such as electronic devices. This situation would carry the same effect of a government providing funds to the companies in the amount of such reduction of prices of inputs. This would then lead to the satisfaction of the first category of direct transfer of funds.[61]

[57]See *id*., Article 1.1(a)(1)(i) – (iv).

[58]*See* U.S. First Written Submission submitted in *China-Rare Earths*, at paras 27–28.

[59]*See ibid*.

[60]*See* Panel Report, *China-Rare Earths*, at para. 2.16.

[61]*See* SCM Agreement, Article 1.1(a)(1)(i); Appellate Body Reports, *Canada – Certain Measures Affecting the Renewable Energy Generation Sector/Canada – Measures Relating to the Feed-In Tariff Program* (WT/DS412/AB/R,WT/DS426/AB/R), at paras. 5.131. (in determining whether a particular program falls under the direct transfer of funds or potential direct transfer of funds, the

Depending upon which aspect of the measures are highlighted, either the third category or the first category of financial contribution can be satisfied for export restraints as examined in the recent WTO disputes. In some occasions, perhaps both aspects of financial contribution are found to exist at the same time.[62] As the Appellate Body in *Canada – Renewable Energy/FIT* opined, a governmental programme can simultaneously fall under different types of financial contribution under Article 1.1(a)(1).[63] The four categories of financial contribution are not mutually exclusive, but are amenable to overlapping application. Either way, financial contribution by the government, the first prong of a subsidy can be deemed to be satisfied in this respect.

In this respect, it should be noted that the intent of the government is not necessarily dispositive. In other words, the fact whether or not a government of a WTO Member has intended to provide financial contribution to the recipients in question is not taken into account in determining the existence of such financial contribution. It is basically an inquiry of factual situation of provision of something with monetary value to the recipient. What has driven the government for such provision is not a controlling factor in this analysis.

4.2.2 Benefit Analysis

The second prong for the existence of a subsidy under the SCM Agreement is the "benefit" analysis. To the extent that domestic manufacturers end up receiving a stable flow of key natural resources at a cheaper price and that their business performance has improved, benefit within the meaning of Articles 1.2 and 14 can also be deemed to exist. As explained above, if key items of raw materials are selected by a government, and corporations using the items now become better off than before due to the easier access to the flow and constant supply of raw materials at cheaper prices, the benefit is arguably found to exist.[64] In essence, the benefit is considered to exist in the amount of the reduced price of the natural resources. Again, this outcome should be proven by the evidence on the record in any dispute settlement proceedings.

Articles 1.2 and 14 of the SCM Agreement require the application of a benchmark, to the extent feasible, in the analysis of benefit.[65] As benefit is a relational concept that requires a comparison with market terms, identifying a market benchmark seems inevitable in a proper benefit analysis. The benchmark provides an

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core scheme of the transaction should be considered instead of the consequential effect as a result of exchange of rights and obligations stemming from any other types of transaction).

[62] *See id.*, at paras. 5.119–120. ("the transaction may naturally fit into one of the types of financial contributions listed," but sometimes a transaction can "be complex and multifaceted," and as a result "different aspects of the same transaction may fall under different types of financial contribution.")

[63] *See id.*, at para. 120.

[64] *See Appellate Body Report*, *Canada-Aircraft*, at para. 157.

[65] *See* Appellate Body Report, *Canada-Renewable Energy/FIT*, at paras. 5.162–166.

objective yardstick in measuring the existence and amount of benefit conferred. Here, the markets to be compared is the ordinary market where the governmental measure does not exist and the present market affected by the governmental measure. The price in the ordinary market provides a benchmark. The difference of price between the benchmark and the present price times the total amount of purchase of the resources would provide the total amount of benefit for a recipient. In the present analysis, the imposition of export restraints has made the prices of these natural resources cheaper than it would otherwise be, so the price difference between the present situation with the export restraints and the hypothetical situation without them would enable one to find benefit and to calculate the amount of the benefit.[66]

It seems that the benefit analysis of export restraints are not distinct from ordinary industrial subsidy programs and that a proper benefit analysis would prove the existence of a benefit within the meaning of Articles 1.2 and 14 of the SCM Agreement. The critical threshold is whether an ordinary market price prior to or in the absence of the governmental measures at issue can be found and confirmed. This task can be accomplished in the context of export restraints if the price in the global market can be confirmed with respect to natural resources at issue. Business sectors have complained of the reduced price of natural resources for companies due to the state imposing export restraints. If a price in the domestic market in the absence of export restraints can be offered, perhaps using the price in the global market as a proxy, a viable benchmark can be found for the comparison within the meaning of Article 14 of the SCM Agreement. As prior precedents opined, it would not be proper to refer to the domestic price of natural resources at present for the purpose of a benchmark because the market could be considered to have been distorted as a result of the governmental intervention.

4.2.3 Specificity Test

With respect to the third prong of a specificity test of the SCM Agreement, it seems that none of the export restraint measures at issue contains the component of explicit inclusion or exclusion of certain industries or companies in laws and regulations *per se*. Thus, on the surface, a *de jure* specificity may not be implicated. Apparently, what are regulated in laws and regulations for export are simply the raw materials and natural resources without mentioning the names of industries or companies. So, in the absence of listing the names of recipient industries or companies, an argument for a *de jure* specificity would be difficult to fare.

Even if there is no statutory limitations regarding the eligibility of this program, it can be shown that the program is *de facto* specific by finding that the recipients of the program was “limited in number.” This also satisfies the specificity within the meaning of Articles 1.2 and 2 of the SCM Agreement. In this instance involving export restraints, it seems to be a *de facto* specificity that is more directly

[66]*See id.*, at paras. 5.183–184.

implicated. The industries that use the designated mineral resources for the production of merchandise or for their business operation are understood to be limited in number.[67] They are mainly electronic device manufacturing industry, steel industry, or other related industries.[68] If this assertion holds true, then over time the recipients of the governmental support may be largely from these industries. If this is the case, an argument can be made that they are *de facto* specific. The fact that only certain industries stand to gain benefit from the export restraints and that, even if many industries enjoy benefit, certain industries are expected to elicit a disproportionately larger amount of benefit, would support the proposition under the prevailing jurisprudence of a specificity test, that a *de facto* specificity is found to exist.

At the same time, to the extent that the exporting industries of the Member adopting export restraints is the focal point of assistance, an argument for an export subsidy can be raised as well under Article 3 of the SCM Agreement.[69] Prohibited

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[67] *See* Marian Paschke & Shi Cheng, *The Applicability of Environmental Exceptions of The GATT To China's WTO-Plus Obligations – WTO Panel And Appellate Body Rulings on the Chinese Export Restrictions of Rare Earths*, *Tungsten and Molybdenum*, Frontiers of Law in China, Vol.10, No.2, June 2015, at 213; Andrew W. Eichne, *More Precious than Gold*: *Limited Access to Rare Elements and Implications for Clean Energy in the United States*, University of Illinois Journal of Law Technology and Policy, 2012, at 262; Marc Humphries, *Rare Earth Elements*: *The Global Supply Chain*, Congressional Research Service, 2010, at 2, available at, http://medallionresources.com/wp-content/uploads/2012/08/Congressionnal-Report-July2010.pdf Accessed on Apr 15, 2016; Jesse Salazar, *Securing Rare Earth*: *Leveraging U.S. Drug Policy for Technological Advantage*, Yale Journal of International Affairs, Vol. 6, 2011, at 127.

See Marian Paschke & Shi Cheng, *The Applicability of Environmental Exceptions of The GATT To China's WTO-Plus Obligations – WTO Panel And Appellate Body Rulings on the Chinese Export Restrictions of Rare Earths*, *Tungsten and Molybdenum*, Frontiers of Law in China, Vol.10, No.2, June 2015, at 213;

See Katherine Weatherford, *The Real Cost of China's Rare Earth Export Quotas on American Job Security,* Sustainable Development Law and Policy, Vol. 12, 2011, at 18.

[68] *See* U.S. First Written Submission submitted in *China-Rare Earths*, at para. 7.

[69] The WTO panel and the Appellate Body have previously addressed the issue of de facto export subsidy on various occasions. In particular, the Appellate Body in *Canada-Aircraft* sets out a three-prong threshold for the demonstration of de facto export contingency: the threshold is whether (1) the "granting of a subsidy"; (2) "is tied to"; (3) "actual or anticipated exportation or export earnings." Appellate Body Report, *Canada-Aircraft*, at para. 169.

With respect to the second prong of the "tied to" analysis, the Appellate Body further elaborated that:

> [T]he ordinary meaning of "tied to" confirms the linkage of "contingency" with "conditionality" in Article 3.1(a). [. . .] This element of the standard set forth in footnote 4, therefore, emphasizes that a relationship of conditionality or dependence must be demonstrated. The second substantive element is at the very heart of the legal standard in footnote 4 and cannot be overlooked. 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.
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> *Id*, at para. 171.

subsidies such as export subsidy is deemed to be specific by definition.[70] This is the reflection that an export subsidy, deemed to cause more harmful distortion to the global trade, is subject to a more stringent regulation under the SCM Agreement. If the evidence proves that the export restraints are geared toward the enhancement of exportation and satisfy the "tied to" requirement, specificity would be found to exist by definition.

5 Conclusion

The SCM Agreement aims to regulate a wide range of governmental support by WTO Members for their domestic industries. Considering how key provisions of the SCM Agreement have been interpreted and applied in prior subsidy disputes, it can be stated that governmental support to be captured by the SCM Agreement is in fact quite broad: not only the provision of cash grant, tax exemptions or goods, but also provision of governmental support in an indirect manner is also implicated by the SCM Agreement. As a matter of fact, direct subsidization has been outweighed by indirect or disguised subsidization in recent disputes. As shown in recent currency controversies among some WTO Members, a government's policy to operate its economic or financial system could sometimes lead to claims under the SCM Agreement.[71]

This rationale can equally apply to export restraints measures. Export restraints have raised controversies recently due to the importance of the natural resources and the scarcity of them. As such export restraints, depending upon how they are

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The Appellate Body also clarified the relationship between the second sentence of footnote 4 and the "tied to" requirement as follows:

> [T]here is a logical relationship between the second sentence of footnote 4 and the "tied to" requirements set forth in the first sentence of that footnote. 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". In our view, merely knowing that a recipient's sales are export-oriented does not demonstrate, without more, that the granting of a subsidy is tied to actual or anticipated exports. The second sentence of footnote 4 is, therefore, a specific expression of the requirement in the first sentence to demonstrate the "tied to" requirement. We agree with the Panel that, under the second sentence of footnote 4, the export orientation of a recipient may be taken into account as a relevant fact, provided that it is one of several facts which are considered and is not the only fact supporting a finding.
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> *Id*, at para. 173.

In light of these precedents, the current jurisprudence can be summarized that, in order to establish that the challenged program is "tied to" export performance, the question is whether the subsidy would *not* have been granted to the corporation if the government had known that no export sales may ensue from the subsidy to be provided under the program.

[70] *See* SCM Agreement, Article 2.3.

[71] *See Appellate Body Report*, *U.S.-AD/CVD*, at paras 271–272.

formulated and administered, could provide a significant support for the business of certain companies that manufacture products using the natural resources as key ingredients. This core aspect of "support" for business entities can ultimately lead to the claims and disputes over subsidy issues under the SCM Agreement. Export restraints have been examined from the perspective of the GATT 1994 and Accession Protocol of certain applicable Members so far and the subsidy aspect discussion has not been conducted yet. While it should be cautioned to offer a general conclusion on a generic type of governmental programs such as export restraints, an argument can be made that certain types of export restraints at least are found to satisfy the elements of a subsidy within the meaning of the SCM Agreement. It can be shown that these export restraints constitute financial contribution by the government that confer benefit on the recipient companies which are specific to certain confined industries. The realization and recognition of the subsidy aspect of the export restraints may facilitate the discussion of how to address the distortive effect, if any, of these measures from the overall framework of the WTO Agreements.

All the unique aspects of the export restraints programs should be put under careful scrutiny of the collective discussions of the international community including the analyses under the SCM Agreement. Export restraints should be adopted and applied in a manner consistent with the applicable WTO Agreements including, most notably, the SCM Agreement.

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Chapter 17
Subsidies Issues in Renewable Energy Trade

Heng Wang

Abstract The chapter analyzes several issues regarding the renewable energy subsidies in trade law. There are uncertainties regarding the WTO-consistence of renewable energy subsidies for goods. It is partially due to the vagueness of WTO rules and insufficient jurisprudence. Among them, issues such as the specificity of subsidies turn to be quite controversial. Given the unclear WTO disciplines on the susidies for goods, renewable energy subsidies for services could be more popular. The "collaboration" between the WTO law and FTAs is desirable to reform the WTO rules on trade remedies and to strike a balance between trade disciplines and environment protection.

Keywords Renewable energy • Subsidies • WTO • FTAs • Specificity • General infrastructure

Professor Jaemin Lee has presented us with a superb chapter analyzing renewable energy subsides and the Agreement on Subsidies and Countervailing Measures (SCM Agreement), which is a highly technical and serious aspect of the interaction between trade and climate change (Lee 2016). In particular, his chapter does a great job of searching possible solutions under the norms of the World Trade Organization (WTO): renewable energy as national general infrastructure project, and renewable energy as non-specific projects. My comments will analyze some legal issues that deserve attention in addressing renewable energy subsidies in the multilateral and regional trade law. In my comments, I plan to discuss several topics: (i) the current state of the WTO disputes relating to renewable energy subsidies, based on an overview of WTO norms; (ii) the issue of renewable energy as "general infrastructure", (iii) the specificity or non-specificity of subsidies for renewable energy, and (iv) the role of free trade agreements (FTAs).

The author is grateful to the help of Zhu Zhang, Zhenyu Xiao, and Shengnan Yu.

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_17

1 WTO Rules and Disputes Related to Renewable Subsidies

The landmark 2015 Paris climate accord is likely to trigger the investment towards zero-carbon energy sources,[1] and renewable energy trade may increase as well. Since enterprises such as start-up small businesses need funding to engage in renewable-energy-related activities, countries may turn to subsidies to fight climate change (e.g., subsidies conditional on the CO_2 reduction). Currently fossil fuel subsidies continue to exceed those for renewable energy by a factor of more than four-to-one,[2] but renewable energy subsidies may increase in the future after the Paris climate change agreement. As found in the EU and Australia, governments may offset the negative effect of a domestic carbon price on energy-intensive trade-exposed industries to tackle competitiveness and carbon leakage concerns arising from imports from nations not pricing carbon.[3] There are different views towards renewable energy subsides. Renewable energy subsidies could be deemed to intervene the market. As adverse views, measures to encourage clean energy is not an intervention into a flawless market but an effort to offset current market distortions, and fossil fuel sector could be a recipient of a negative subsidy arising from the failure to price carbon emissions to reflect their climate change impacts.[4] In view of climate change, not all energy subsidies are harmful, and some may be needed to address the path dependency created by technology lock-in – the market dominance by an inferior technology (e.g., coal electricity generation).[5]

From the trade law perspective, the WTO-consistency issue needs to be taken into consideration in the design and implementation of subsidies on renewable energy. Domestic countervailing investigations have been taken regarding renewable energy subsidies, and disputes over renewable energy have arisen in the WTO dispute settlement system. For the former, the examples include China's countervailing duties on US solar-grade polysilicon,[6] and European Commission's probe into whether Chinese solar panel manufacturers had been provided with unfair subsidies, which continued after EU-China solar panel deal.[7] A typical one of the latter is *India – Certain Measures Relating to Solar Cells and Solar Modules* (*India – Solar Cells*) filed by the U.S., in which the panel seemingly ruled that

[1] Coral Davenportdec, *Nations Approve Landmark Climate Accord in Paris*, The New York Times, Dec. 12, 2015. 2015.

[2] Tom Arup, *Paris UN Climate Conference 2015: Australia rejects fossil fuel pledge*, The Sydney Morning Herald, December 1, 2015. 2015.

[3] Joshua P. Meltzer, *The Trans-Pacific Partnership Agreement, the Environment and Climate Change*, *in* Trade Liberalisation and International Co-operation: A Legal Analysis of the Trans-Pacific Partnership Agreement 228, (Tania Voon ed. 2013).

[4] Id. at 227.

[5] Id. at 227.

[6] *China Announces Anti-Subsidy Duties on US Solar-Grade Polysilicon*, 17 Bridges (2013).

[7] *EU-China Solar Panel Deal in Place; Subsidies Probe to Continue*, 17 Bridges (2013).

India's federal solar program violates trade rules due to local-purchase requirements for solar cells and modules.[8] Pitifully, the panel report of this dispute has not been publicly released at the time of writing, and further analysis of this case will be meaningful. The European Union (EU) and Japan filed the *Canada – Certain Measures Affecting the Renewable Energy Generation Sector (Canada – Renewable Energy)*, which targeted at Canada's measures concerning domestic content requirements in the feed-in tariff program and has been appealed to the Appellate Body. Moreover, as a WTO dispute that has not entered the panel proceedings, China requested the consultation with the EU, Greece and Italy regarding domestic content restrictions that affect the renewable energy generation sector concerning the feed-in tariff programs of EU member countries.[9] Up to now there is limited WTO jurisprudence on renewable energy subsidies.

Under the WTO law, a subsidy is deemed to exist if (i) there is a financial contribution by a government or public body, or income or price support in the sense of Article XVI of the General Agreement on Tariffs and Trade 1994 (GATT); and (ii) a benefit is conferred.[10] For instance, the free allowance of carbon emission to offset a domestic carbon price on energy-intensive industry may constitute a financial contribution and a benefit within the meaning of the SCM Agreement.[11] For the benefit comparison, the Appellate Body has indicated in *Canada – Renewable Energy* that it should be conducted in competitive markets for renewable energy that are created by the government definition of energy supply-mix.[12] The financial contribution by the government for renewable energy cannot "in and of itself" be deemed as conferring a benefit in the meaning of Article 1.1(b) of the Agreement on Subsidies and Countervailing Measures (SCM Agreement).[13] The Appellate Body's reasoning seems to favour renewable energy to some extent and the implications need to be observed in the long term.

Subsidies are expressly prohibited if they are contingent upon export performance or the use of domestic over imported goods.[14] Such contingency includes *de jure* and *de facto* ones, and it could be the sole condition or one of several other conditions.[15] Therefore, countries cannot make or maintain such prohibited subsidies[16] for renewable energy. The SCM Agreement's prohibition of domestic

[8]Rajesh Roy, *WTO Panel Rules Against India's Solar Program*, The Wall Street Journal, Sept. 1, 2015.

[9]European Union and Certain Member States – Certain Measures Affecting the Renewable Energy Generation Sector – Request for Consultations by China, 1–4 (2012).

[10]World Trade Organization, *Agreement on Subsidies and Countervailing Measures*, art. 1.1.

[11]Robert Howse, *Climate Mitigation Subsidies and the WTO Legal Framework: A Policy Analysis*, 9 (2010).

[12]Appellate Body Report, Canada – Certain Measures Affecting the Renewable Energy Generation Sector, WT/DS412/AB/R, WT/DS426/AB/R, para. 5.178.

[13]Id. at, para. 5.175.

[14]SCM Agreement, art. 3.1.

[15]SCM Agreement, art. 3.1.

[16]SCM Agreement, art. 3.2.

content requirements as a condition for a subsidy has been invoked in WTO disputes. Articles 3.1(b) and 3.2 of the SCM Agreement are among legal basis of the arguments of claimants in *Canada – Renewable Energy* and *India – Solar Cells*, and of China's arguments in its WTO consultation request with the EU regarding certain measures affecting renewable energy generation sector.[17] These measures in dispute are alleged to be prohibited subsidies.

Moreover, if subsidies are specific to certain enterprises or industries[18] and cause adverse effects to the interests of other Members,[19] they constitute actionable subsidies. In the most recent WTO dispute of *India – Solar Cells,* provisions of the SCM Agreement on actionable subsidies have been invoked (i.e. Articles 5(c), 6.3(a), and 6.3(c)), along with the rules on prohibited subsidies. The U.S. claimed in this dispute that the measures constitute actionable subsidies, which seemingly caused serious prejudice to the interests of the U.S. through displacement or lost sales of imports of U.S. products into India.[20] Claims based on actionable subsidies are likely to increase in the future, and the interpretation of WTO rules will be crucial.

2 Is Renewable Energy "General Infrastructure"?

Renewable energy helps to maintain the environment, but it remains an open question whether it constitutes "general infrastructure". The term of general infrastructure has been interpreted in *European Communities – Measures Affecting Trade in Large Civil Aircraft* (*EC – Aircraft*). Under Article 1.1(a)(1)(iii) of the SCM Agreement, general infrastructure is not a financial contribution, but infrastructure that is "other than general" is.[21] Although the provision of infrastructure usually have some public policy objectives, general infrastructure does not cover all infrastructure "fulfilling a public policy objective" to avoid rendering the word "general" inutile.[22] In the view of the panel in *EC-Aircraft*, no type of infrastructure, including railroads or electrical distribution systems, is "inherently 'general' per se".[23] In this dispute, the Appellate Body does not have a different position regarding this issue.

[17]European Union and Certain Member States – Certain Measures Affecting the Renewable Energy Generation Sector – Request for Consultations by China, 3, 2012.

[18]SCM Agreement, art. 2.

[19]SCM Agreement, art. 5.

[20]India – Certain Measures Relating to Solar Cells and Solar Modules – Request for consultations by the United States 2 (2013).

[21]Appellate Body Report, European Communities – Measures Affecting Trade in Large Civil Aircraft, para. 963, WT/DS316/AB/R

[22]Panel Report, European Communities – Measures Affecting Trade in Large Civil Aircraft, WT/DS316/R, para 7.1038.

[23]Id. para. 7.1039.

Based on the ordinary meaning, general infrastructure refers to infrastructure that is available to "all or nearly all entities" rather than a limited number of entities.[24] It is to be decided on a case-by-case basis, considering *de jure* or *de facto* limitations on access to the infrastructure.[25] A number of factors needs to be examined, including (i) circumstances of the creation of the infrastructure, (ii) the infrastructure type, (iii) the conditions of the infrastructure provision, (iv) the beneficiaries of the infrastructure, and (v) the law applicable to the infrastructure.[26] For the last consideration, one of the key issues is the limitation on access to or use of the infrastructure. The interpretation of general infrastructure would not be an easy exercise. On a related note, there could be a claim against electricity infrastructure, which may be difficult to succeed.[27]

3 Are Subsidies for Renewable Energy Specific?

Subsidies for renewable energy could avoid specificity and therefore are not inconsistent with the SCM Agreement. However, there exist considerable uncertainties. Article 2.1(a) of the SCM Agreement provides that the specificity exists when the access to the subsidy is explicitly limited to "certain enterprises". Since there is no definition of terms such as "certain enterprises" and "group of enterprises or industries", they can be implemented in a broad or narrow way that indicates political considerations instead of economic principle.[28]

Articles 2.1(b) and 2.1(c) of the SCM Agreement are also key provisions here as they deal with neutral non-specific subsidies and *de facto* specificity respectively. Under Article 2.1(b), the eligibility criteria of subsidies are deemed to be objective if they (i) are neutral, (ii) do not favor particular enterprises, and (iii) are economic ones and apply across the board (e.g. employee number, enterprise size).[29] Moreover, eligibility shall be automatic, and the criteria must be strictly implemented and clearly stated in rules for verification.[30] If all these conditions are met, the subsidies can avoid specificity. The focus of the inquiry in Articles 2.1(a) and

[24]Id. para. 7.1036.

[25]Id. para. 7.1039.

[26]Id. para. 7.1039.

[27]Luca Rubini, ASCM Disciplines and Recent WTO Case Law Developments: What Space for 'Green' Subsidies?, EUI Working Paper RSCAS 2015/03, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2553912, 4 (2015).

[28]Alan O. Sykes, The Questionable Case for Subsidies Regulation: A Comparative Perspective, Stanford University School of Law & Economics Research Paper Series Paper NO. 380, http://ssrn.com/abstract=1444605, 32.

[29]SCM Agreement, art. 2.1(b) and footnote 2.

[30]SCM Agreement, art. 2.1(b).

2.1(b) is the eligibility for a subsidy rather than whether certain enterprises did receive the subsidies.[31]

In theory, subsidies in renewable energy would not be regarded as specific if they meet these requirements. There are arguments that non-discriminatory energy saving subsidies that do not favor certain technologies could be deemed as non-specific,[32] and that subsidies in renewable energy would not be specific if their criteria are horizontal and neutral, such as those conditional on the adoption of a technology that provides a certain level of green house gas reduction.[33] One may also argue that subsidies provided to users of renewable energy are not specific under the SCM Agreement when they are available generally to all businesses.[34] In any case, the determination of specificity will be fact-specific.[35]

Even if the renewable energy subsidies gain non-specificity under Article 2.1(b) of the SCM Agreement, they are subject to Article 2.1(c) of the SCM Agreement that deals with the *de facto* specific cases. A number of other factors may be considered, including the use of subsidy program by a limited number of businesses, predominant use by certain firms, certain businesses obtaining disproportionately large amounts of subsidy, and the way in which the authorities use discretion in granting a subsidy (with particular emphasis on the consideration of information on grant application outcomes and the reasons of decisions).[36] As the verb “may” instead of “shall” is used, an authority could look at any rather than all of these four indicators of specificity here.[37] In this process, account shall be taken of the diversification of economic activities in the jurisdiction of the granting authorities, and the length of subsidy program operation time.[38] Generally the principles in Article 2.1 shall be interpreted together,[39] and the breadth or narrowness of specificity is not subject to rigid quantitative definition.[40] However, these WTO rules and jurisprudence are still fuzzy.

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[31] Appellate Body Report, United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, WT/DS379/AB/R, para 368.

[32] Sadeq Z. Bigdeli, *Resurrecting the Dead? The Expired Non-Actionable Subsidies and the Lingering Question of ‘Green Space’*, 8 Manchester Journal of International Economic Law 2, 22, 26 (2011).

[33] Daniel Peat, *The Perfect FIT: Lessons for Renewable Energy Subsidies in the World Trade Organization*, 1 LSU Journal of Energy Law and Resources, 56–57 (2012).

[34] Robert Howse, Climate Mitigation Subsidies and the WTO Legal Framework: A Policy Analysis, https://www.iisd.org/pdf/2009/bali_2_copenhagen_subsidies_legal.pdf, 13 (2010).

[35] See, eg, Ilaria Espa and Sonia E. Rolland, *Subsidies, Clean Energy, and Climate Change*, http://e15initiative.org/publications/subsidies-clean-energy-and-climate-change/, 5 (A grant for the development of hydrogen fuel cells may not be specific due to the lack of a definable industry that is the beneficiary. In contrast, research and development subsidies to improve the efficiency of photovoltaic panels may be specific if they aim at solar panel corporations) (2015).

[36] SCM Agreement, art. 2.1(c) and footnote 3.

[37] Panel Report, United States – Final Countervailing Duty Determination with respect to certain Softwood Lumber from Canada, WT/DS257/R, para. 7.123.

[38] SCM Agreement, art. 2.1(c).

[39] Appellate Body Report, United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, WT/DS379/AB/R, para 370.

[40] Panel Report, United States – Subsidies on Upland Cotton, WT/DS267/R, para 7.1142.

Regarding renewable energy subsidies, energy efficiency could be "*de facto*" specific to leaders of energy efficiency technologies or energy-intensive industries.[41] For instance, in analyzing the indicator of predominant use by certain enterprises, both the economic diversification and the subsidy program operation length matter. Renewable energy subsidies should be available to a broader range of sectors when the subsidies are adopted by a highly diversified economy. If only limited industries benefit from the subsidy program in such an economy, it is more likely to indicate predominant use.[42] Same subsidy program in an economy made up of a few industries is not necessarily deemed as "predominant use" by certain industries.[43] Renewable energy subsidies are usually in operation for a relatively short time. In the same vein, this fact does not necessarily demonstrate the predominant use by certain businesses, since a new renewable energy program has not operated for sufficient time to assess its entire impact on the economy.[44] Meanwhile, it does not always need to make the decision until the entire life of a subsidy program ends. With operation time of renewable subsidy program passes by, the burden may increase for such program to prove its non-specificity.

Since *de facto* specific cases are prone to an intrinsic uncertainty given that nearly all subsidies regardless of their general availability may have a disproportionate effect on different businesses, one may argue that what matters is the inquiry into the object of the measure rather than the factors listed in Article 2.1(c) of the SCM Agreement.[45] Meanwhile, the interpretation of Article 2.1(c) should not go too far to render Article 2.1(b) redundant.

As WTO members could hardly reach a decision here, the jurisprudential uncertainty remains. Moreover, the WTO jurisprudence has indicated that the large number of businesses or sectors affected by a measure could be insufficient to prove that the subsidy is not specific.[46] In certain nations, energy-intensive industries may be highly disproportionate users of subsidies of free emission allowance, it may indicate as least a *prima facie* case of *de facto* specificity.[47] Since *de facto* specificity is unclear in the WTO jurisprudence, subsidies that are limited to few enterprises, or are provided as per objective criteria, could be specific.[48] There are arguments that subsidies for renewable energy may be specific,

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[41]Bigdeli, Manchester Journal of International Economic Law, 26 (2011).

[42]EC and certain member States – Large Civil Aircraft, at para. 7.975.

[43]Id. para. 7.975.

[44]Id. para. 7.976.

[45]Bigdeli, Manchester Journal of International Economic Law, 21 (2011).

[46]Luca Rubini, *Ain't Wastin' Time no More: Subsidies for Renewable Energy, the SCM Agreement, Policy Space, and Law Reform*, 15 Journal of International Economic Law 525, 548 (2012).

[47]Howse, 9 (2010).

[48]Aaron Cosbey and Petros C. Mavroidis, A Turquoise Mess: Green Subsidies, Blue Industrial Policy and Renewable Energy: the Case for Redrafting the Subsidies Agreement of the WTO, EUI Working Paper RSCAS 2014/17, 18 (2014).

and that the design and breadth of measures are not so relevant given the clean energy industry remains one industry in the national economy.[49]

As indicated above, there are divergent views of the SCM Agreement regarding the specificity issue when it applies to renewable energy subsidies. From the legal perspective, a range of factors will be considered in analyzing the WTO-consistency of renewable energy subsidies. It will make it a difficult job to design a WTO-consistent subsidy program as uncertainty on the WTO rule interpretation remains. In practice, countries may also encounter difficulties such as political and financial viability of extending a general subsidy to all economic sectors, costly administrative burden of maintaining a WTO-consistent subsidy, which may not be an easy job even for developed countries.[50]

4 The Possible Role of FTAs

WTO trade remedies rules need to be reformed to mitigate the environmental damage due to green industrial policy disputes.[51] As the WTO rulemaking encounters difficulties for quite some time, countries may regard the FTAs, particularly larger or mega ones, as possible options to address the issue of renewable energy subsidies. The WTO may be spurred into action by these FTA rules if properly managed. It may require new FTA rules that go beyond the SCM Agreement. However, bilateral FTAs are more likely to follow the WTO rules and are less likely to develop new rules regarding the subsidies in sustainable energy. Even for the mega FTA, it seems that the Trans-Pacific Partnership Agreement (TPP) has not made much progress regarding renewable energy subsides in its rules on trade remedies.

The FTA may set disciplines for services subsides and strike a balance between climate change and trade liberalization. Services subsidies are not subject to strict disciplines under the WTO norm. For instance, subsidies to waste treatment as a service fall outside the SCM Agreement, and waste treatment could be an essential part of bioenergy production.[52] Countries may choose service subsidies on renewable energy, and subsidies for goods may be transformed to subsidies for services.

In the future, the FTAs may also encounter difficulties. One thorny question is whether the FTA may legitimize WTO-inconsistent subsides on renewable energy in trade in goods. It reflects the delicate relationship between multilateral and regional trade law.

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[49]Rubini, Journal of International Economic Law, 548–549 (2012).

[50]Peat, LSU Journal of Energy Law and Resources, 57–58 (2012).

[51]Mark Wu & James Salzman, *The Next Generation of Trade and Environment Conflicts: The Rise of Green Industrial Policy*, 108 Northwestern University Law Review 401, 474 (2014).

[52]Bigdeli, Manchester Journal of International Economic Law, 22 and footnote 88 (2011).

5 Conclusion

As the multilateral trade system is difficult to produce new rules regarding renewable energy subsidies in the short run, the WTO-legality of the renewable energy subsidy would be a matter of interpretation. A turn to the interpretation of WTO rules (including the relationship between letters (b) and (c) of the SCM Agreement Article 2.1) offers some promise. The arguments of the renewable energy programs as general infrastructure projects and their non-specificity are quite useful in balancing trade and environment. It also provides a perspective that deserves more attention in the future WTO jurisprudence. Meanwhile, there are different views regarding renewable energy subsidies that deserve attention.

The tension may exist between trade law and renewable energy subsidies from the perspective of rules on subsidies. On the one hand, there is a lack of explicit textual support in WTO norms for subsides in renewable energy. On the other hand, renewable energy subsidies programs have often been adopted by subnational governments who are less capable of taking into account WTO rules in their design compared with national governments.[53] The analysis of WTO-consistency of renewable energy subsidies probably could only be conducted on a case-by-case basis, and the arguments related to WTO subsidy rules could be made in different ways. Some observations could be made here.

First, renewable energy subsidies for goods may not necessarily be consistent with the SCM Agreement. Their design and implementation is crucial. Not all infrastructures are "general", and uncertainty in the rule interpretation can hardly be eliminated. Renewable energy subsidies could be argued to be "specific", if renewable energy is compared with traditional energy, energy-intensive industries compared with other industries. In practice, WTO members may encounter difficulties in implementing WTO-consistent general subsidies that evade specificity. The political, financial and other inputs are needed to make them happen. It may be quite challenging to provide renewable energy subsidies as a general infrastructure given the funding capacity limit of countries.

Second, WTO rule interpretation cannot go too far and the rule making at the WTO is encountering difficulties. It makes the "collaboration" between the WTO law and FTAs desirable. The FTA rules and their interpretation could base on and reform the counterpart of the WTO. FTAs may have a role in addressing renewable energy subsidies for goods. Given the legal uncertainty of renewable energy subsides for goods under the WTO law, it may lead to the consideration of subsidies for relevant service and service suppliers. FTAs could also develop rules to restrict unwarranted renewable energy subsidies for services.

Last but not least, a number of questions need to be answered including the following ones: how should Article 2.1(c) be interpreted to give effect to Article 2.1 (b) of the SCM Agreement? What is the role of the FTAs including mega FTAs

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[53] Timothy Meyer, *Energy Subsidies and the World Trade Organization*, 17 ASIL Insights (2013).

regarding the relationship between trade and renewable energy? Should services subsidies remain outside the reach of trade disciplines? In the end, the trade regime should seek the proper way of supporting policy autonomy (e.g. measures to promote energy efficiency and encourage the use of renewable energy) and curbing disguised trade protection.

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Part VII
Energy Trade and Investment Treaties

Chapter 18
International Energy Trade and Investor-State Arbitration: What Role for Sustainable Development?

Susan L. Karamanian

Abstract Energy trade entails more than the purchase and sale of sources of power. It involves transactions involving equipment for production, international shipping and transmission, and an array of sophisticated financial products that seek to reduce risk or costs. Accompanying the internationalization of the energy market is an increasing number of international investment agreements (IIAs), which have facilitated the global growth of the industry. In addition to providing protection to investors from State Parties to treaties when they invest in corresponding State Parties, IIAs may also allow an aggrieved investor to arbitrate a claim against a Host State.

Concerns have been raised that IIAs and investor-state arbitration are at odds with a perceived competing international norm, sustainable development. This chapter analyzes the applicable international legal regime with a specific focus on the text of IIAs, interpretive standards, and arbitral awards. It argues that in a number of IIAs there is room for arbitral tribunals to apply international law and give effect to sustainable development principles. The challenge is for tribunals to conduct an analysis in a disciplined way. The chapter sets forth three rules to help guide tribunals in this effort.

Keywords International energy trade • Sustainable development • International investment agreements • Energy charter treaty • Vienna convention on the law of treaties

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_18

1 Introduction

The twentieth century witnessed the emergence of the **global energy market**. Exports of oil from the world's largest producers, such as the Gulf States and Venezuela, made their way to markets in Europe, the United States, and Asia.[1] With a vibrant international sales market, trade in oil traditionally was defined by a buyer purchasing oil from a willing seller. The emergence of international commerce, along with the development of a robust international financial system, changed the dynamics. New sources of energy, coupled with the ability to transmit them across borders due to a bustling infrastructure, helped meet the world's increasing demand for energy. Major financial institutions and stand-alone trading houses realized that energy sales contracts, in particular, had value beyond the sale itself. They offered to suppliers an array of **financial products** to hedge their exposure to price changes. The trading market extended to various commodities and the resulting electricity.[2]

In the latter part of the Century, States became linked under a series of international investment agreements (IIAs), designed to protect an investor from one State Party to a treaty when it invests in the other State Party. Principal among the treaties is the Energy Charter Treaty (ECT), to which more than 50 States and the European Union are parties.[3] More than 2200 bilateral investment treaties (BITs) and more than 200 free trade agreements (FTAs) and other IIAs are in force.[4] Many IIAs enable an investor, which claims that the Host State has breached a treaty's protection measure, to arbitrate claims directly against the Host State.[5]

The intense focus on energy production and consumption, with investors and their investments receiving what some consider special protection under IIAs, has raised questions about the overall cost of the investor-state regime. This is particularly true given concerns about the environmental quality of the investment and the possibility it could undermine sustainable development. The full cost issue is critical as the treaties could limit the ability of States to properly regulate the environment or promote an orderly means to economic development. That lack of regulation, in turn, could have consequences beyond the border of a State. The issue is more pronounced today as certain Asia-Pacific countries, along with the United States, Canada, Mexico, Peru and Chile, as well as the European Union and the United States, are negotiating to expand the trade and investment network under the rubric of the **Trans-Pacific Partnership (TPP)** and the **Transatlantic Trade and Investment Partnership (TTIP)**, respectively.

So, what is the role of sustainable development in international energy trade and investor-state arbitration? This paper addresses the question and argues that there is

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[1]See Yergin (1992).

[2]See, e.g., Brunet and Shafe (2007).

[3]The Energy Charter Treaty, Dec. 17, 1994, 2080 U.N.T.S., 34 I.L.M. 360 [hereinafter "ECT"].

[4]UNCTAD (2016).

[5]See Sect. 2.

room in existing treaties for arbitrators to give effect to environmental concerns and development objectives. The treaties have the potential to promote a measured foreign investment as some of them at least inject sustainability as a value. Without the treaties, the foreign investment may still occur without any State acknowledgment of the need for sustainable investment. A more orchestrated and meaningful approach, one with specific guidelines on balancing competing interests, would likely entail a re-drafting of IIAs. The latter could be challenging given the intense political and economic issues at stake in the IIAs.[6]

2 International Energy Trade

2.1 Traditional Perspective

The concept of international energy trade is broad. It could be considered as anything related to the trans-border sale and purchase of energy.[7] In the traditional sense, included would be the energy source, supply conditions, production facilities, transmission services, such as ports, shipping, pipelines, and power grids, and export and import restrictions.

Each element of the trading process implicates sustainability issues. For example, allowing certain forms of production could be fraught with environmental consequences. Hence, after the **Fukushima Daiichi nuclear power plant** disaster in Japan, the Federal Republic of Germany announced a phase out of the production of nuclear power in Germany. The effect of Germany's decision extended beyond local environmental safety concerns as investors in Germany's nuclear production market were from outside of Germany.[8] Lured with the promise of a lucrative long-term project the investors were cut out of the market.[9] Or, as another example, incentives in the form of feed-in tariffs to promote the development of alternative energy sources, such as solar energy, affect the supply of energy in domestic and potentially international markets. A curtailment of them, as recently happened in Spain and the Czech Republic, will affect energy supply from a source that is environmentally-friendly. And, like the situation in Germany, foreign investors have borne the brunt of the decisions of Spain and the Czech Republic.[10]

Beyond supply conditions and restrictions are regulations that affect transmission. The decision in the United States not to allow the **Keystone Pipeline** to expand from Oklahoma to refineries in the Gulf Coast of Texas and to the north from Kansas to Alberta, Canada, illustrates the extent to which the trans-border

[6]But see UNCTAD (2014b) Reform of Investment Treaties.

[7]See Leal-Arcas and Abu Gosh (2014), pp. 9–10.

[8]Vattenfall AB v. Federal Republic of Germany, ICSID Case No. ARB/12/12.

[9]Vattenfall.

[10]*See* UNCTAD (2014a) Recent Developments.

transmission affects the local environment. The competing objectives, however, are access to the resource and the economic development promised from the pipeline.[11] Similarly, restrictions on shipping, such as those under the **International Convention for the Prevention of Pollution from Ships**, impose costs on tankers yet serve compelling environmental objectives.[12]

2.2 Expansive Perspective

Understanding international energy trade from traditional transactional concepts does not do justice to the term. Underlying many transactions is a vast, sophisticated financial network that facilitates sales and purchases and enables more efficient operations by hedging risk. If financial instruments, which are a step or two removed from the trade in the energy product itself, are considered an investment in energy, they and the initiators of them, principally financial institutions, could shape the allocation of priorities. And could this power also extend to mere holders of the instruments, such as purchasers with no knowledge of or interest in the transaction other than to receive some financial benefit from the instrument?

3 The Investment Treaty Regime: Substance and Process

The landscape regulating international energy trade is defined, in part, by the IIAs that protect investors and investments. The treaties are far from uniform and each must be examined carefully to appreciate the precise investment protection measures, the beneficiaries of them, and the means, if any, to resolve investor disputes against the host State if treaty promises are breached.

3.1 Investment Protection

IIAs have a similar structure. First, they define the investments to be protected. The definition is usually broad, such as “every kind of asset, owned or controlled directly or indirectly by an Investor” including tangible and intangible assets, stock, and claims to money.[13] The ECT has an additional condition, namely, that the investment be “associated with an Economic Activity in the Energy Sector.”[14]

[11] For an assessment of competing interests, see Elbin (2014).

[12] International Convention for the Prevention of Pollution from Ships, 1973, 12 I.L.M. 1319 [Marpol Convention].

[13] ECT Art. 6(1).

[14] ECT Art. 6(1).

Second, the term "investor" is usually a natural or juridical person with ties to one of the State Parties to the treaty.[15] Third, the IIA specifies the investment protections afforded the Investor and/or the Investment. For example, the ECT provides the following:

1. **Fair and equitable treatment**: requiring the Host State to "include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. ... In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations."[16]
2. **Protection and Security**: "Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal."[17]
3. **National treatment** or **most favored nation treatment**: "'Treatment' means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable."[18]
4. Prohibition on **Expropriation**, subject to public purpose that is not discriminatory, conditioned upon due process and compensation.[19]

3.2 Investor-State Arbitration

Many IIAs provide for arbitration of an investor's claim that the host State failed to satisfy the investment protections. Under the ECT, for example, the aggrieved investor may submit the dispute for resolution in arbitration before the **International Centre for Settlement of Investment Disputes (ICSID)**, to an arbitrator or ad hoc arbitration tribunal under the **Arbitration Rules of the United Nations Commission on International Trade Law** (UNCITRAL), or an arbitral tribunal under the **Arbitration Institute of the Stockholm Chamber of Commerce.**[20] The arbitrator or tribunal is to resolve the dispute "in accordance with th[e] Treaty and applicable rules and principles of international law."[21]

For ICSID disputes, when the governing law is not selected, Article 42 of the **Convention on the Settlement of Investment Disputes Between States and Nationals of other States (ICSID Convention)** provides that "the Tribunal shall

[15]ECT Art. 6(1).

[16]ECT Art. 10(1).

[17]ECT Art. 10(1).

[18]ECT Art. 10(3).

[19]ECT Art. 13.

[20]ECT Art. 26(4).

[21]ECT Art. 26(6).

apply the Law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable."[22] References in IIAs and the ICSID Convention to international law have allowed general principles relating to international environmental law, including sustainable development, to at least become part of the investor-state dialogue.

Some arbitration rules allow for the involvement of non-parties. In 2006, the ICSID Arbitration Rules were amended to give the tribunal the discretion, after consulting with the parties, to allow non-parties to the arbitration to file a written submission.[23] Tribunals constituted under the UNCITRAL Arbitration Rules have allowed *amicus curiae* submissions setting forth environmental law arguments.[24] This development recognizes the more public nature of the investor's claims and enables those affected by the case to petition the tribunal to present issues otherwise not raised.

3.3 Other Key Aspects

IIAs may specify that the investment protection measures be considered in light of other important societal objectives, such as protection of the environment. The **North American Free Trade Agreement (NAFTA)** among Canada, Mexico and the United States provides that one of the objectives is to "improve working conditions and living standards" in the territories of the NAFTA States and to achieve the NAFTA Goals "consistent with environmental protection and conservation" and "to strengthen the development and enforcement of environmental laws and regulations."[25] The ECT recognizes the need "for the most efficient exploration, production, conversion, storage, transport, distribution and use of energy," refers to specific international environmental treaties, and recognizes "the increasingly urgent need for measures to protect the environment."[26]

The 2012 Model Bilateral Investment Treaty of the United States (**2012 US Model BIT**) excludes from indirect expropriation "non-discriminatory regulatory actions . . . that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment."[27] Exceptions clauses can be found in other IIAs although these other clauses may limit the

[22]ICSID Convention, Mar. 18, 1965, ch 1, § 1, art. 42, 17 UST 1270, 1273, 575 UNTS 159, 62.

[23]ICSID Arbitration Rules (as amended Apr. 10, 2006) Rule 37(2).

[24]See, e.g., Glamis Gold Ltd. v. United States, UNCITRAL Arb., Submission of the Quechan Indian Nation (Oct. 16, 2006).

[25]NAFTA (Preamble), Dec. 17, 1992, 32 I.L.M. 289, 297 (1993) [hereinafter, "NAFTA"].

[26]ECT (Preamble).

[27]2012 US Model Bilateral Investment Treaty, Annex B 4(b) [hereinafter "2012 US Model BIT"]. See also Canadian Model BIT, Annex B.13(1) "non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation").

measures to those that are consistent with the investment provisions in the treaties.[28]

The 2012 US Model BIT also recognizes that it is inappropriate for State parties "to encourage investment by weakening or reducing the protections afforded in domestic environmental laws" and domestic labor laws.[29] In a similar vein, the **Canada-Romania BIT** allows a State to adopt, maintain or enforce measures "it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns."[30] These clauses resemble language in treaty preambles that signal that the treaties seek to promote investment in a "sustainable manner"[31] or in a way "consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights."[32] In this regard, the treaties could be considered in a positive light beyond their investment objectives; they are part of an international regime that infuses environmental and other societal goals as part of promoting foreign investment.

Some treaties have recognized the States' duty to hold corporations to a certain standard of conduct under principles of corporate social responsibility. For example, the **Free Trade Agreement between Canada and Peru** provides as follows:

> Each Party should encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their internal policies, such as statements of principle that have been endorsed or are supported by the Parties. These principles address issues such as labour, the environment, human rights, community relations and anti-corruption. The Parties remind those enterprises of the importance of incorporating such corporate social responsibility standards in their internal policies.[33]

Recent European FTAs have similar language[34] as does the Investment Chapter of the newly-proposed TPP.[35]

The ECT elaborates on the duty of a State Party to the treaty regarding the environment. Unlike other IIAs, Article 19(1) of the ECT offers a relatively detailed road-map on how a State should proceed:

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[28]Krommendijk and Morijn (2009), pp. 434–435; Mann (2008), p. 19.

[29]2012 US Model BIT Arts. 12(2); 13(2).

[30]Agreement for the Promotion and Reciprocal Protection of Investments, Can.-Rom. Art. XVII (2), May 8, 2009.

[31]Agreement between Canada and the Republic of Peru for the Promotion and Protection of Investments (Preamble) (2006).

[32]2012 US Model BIT (Preamble); Agreement Between Japan and the Socialist Republic of Viet Nam for the Liberalization, Promotion and Protection of Investment (Nov. 14, 2003) (the treaty's investment objectives "can be achieved without relaxing health, safety and environmental measures of general application").

[33]Canada-Peru Free Trade Agreement Art. 810 (Aug. 1, 2009).

[34]Alschner and Tuerk (2013), pp. 217, 227.

[35]Chapter 9, Investment, Art. 9.16, Trans-Pacific Partnership Agreement, available at https://ustr.gov/sites/default/files/TPP-Final-Text-Investment.pdf (last visited Jan. 23, 2016).

> In pursuit of sustainable development and taking into account its obligations under those international agreements concerning the environment to which it is party, each Contracting Party shall strive to minimize in an economically efficient manner harmful Environmental Impacts occurring either within or outside its Area from all operations within the Energy Cycle in its Area, taking proper account of safety.[36]

This language acknowledges the goal of sustainable development and States' obligations under environmental treaties. It recognizes the duty of a State to act in an "economically efficient manner" to minimize "harmful Environmental impacts."[37] Article 19(1) goes further and requires a State Party to "act in a Cost-Effective manner" and to "strive to take precautionary measures to prevent or minimize environmental degradation."[38] The State Parties agree to the **polluter pays principle a**nd also agree to a range of measures aimed at promoting the environment.[39] While the Article 19 obligations are included in Part IV of the ECT, and thus not subject to investor-state arbitration under the treaty, the principles surely could be applied to assess whether the challenged State conduct violated an investment protection measure or they arguably could be used to elucidate the protection measures.

Of note, most IIAs, except the ECT, give little guidance as to the meaning of environmental objectives or sustainability. The concept of sustainable development is far from settled. The International Court of Justice recognized it in a general way: "reconcil[ing] economic development with protection of the environment."[40] Professor Andrew Newcombe has urged assessing IIAs in a more defined way, particularly in light of the **International Law Association's 2002 New Delhi Declaration of Principles of International Law Relating to Sustainable Development** (Delhi Principles). While not law, the Delhi Principles take a broad and integrated approach to sustainable development.[41] They focus on sustainable use of natural resources, equity, poverty eradication, shared responsibilities, application of the precautionary principle, participation, access to information and justice**, good governance**, and "integration and interrelationship, in particular in relation to human rights and social, economic and environmental objectives."[42] Such broad goals, when considered in light of specific investment protection measures in the IIAs, could open an array of issues for an arbitral tribunal. Hence, if they are indeed applicable to resolution of an investor's claim against a State they could have wide-reaching implications.

Further, the treaties do not typically impose direct duties on the investor before undertaking an investment in a host country and this asymmetry has given rise to a

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[36]ECT Art. 19(1).

[37]ECT Art. 19(1).

[38]ECT Art. 19(1).

[39]ECT Art. 19(1).

[40]Gabčíkovo Nagymaros Case (Hung. v. Slovk.) [1997] ICJ Rep. 7, 78, para. 141 (Judgment).

[41]Newcombe (2007), pp. 359–360.

[42]Newcombe (2007), p. 360.

number of criticisms. For example, one could imagine a treaty that required an investor, before engaging in mining in the host State, to produce an environmental impact statement, or perhaps have some form of local community engagement. Such an approach, however, would assume that Host State law already does not impose such a requirement. Also it could be considered at odds with the investment objectives of the treaty.

The asymmetry could be compounded by the fact that investors are the only party that benefit from the dispute resolution mechanism. To level the playing field, some have suggested that non-investor stakeholders also be given access to a dispute mechanism system, such as arbitration of a claim against the investor due to an investor's human rights violations.[43]

In interpreting investment treaties, Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT) requires that, together with the treaty context, effect should be given to 'any relevant rules of international law applicable in the relations between them.'[44] As noted earlier, many treaties are to be interpreted under international law, resulting in the potential for harmonizing what may be perceived as conflicting norms, such as investment in energy verses sustainable growth.[45] This paper urges a tempered use of international law to reconcile these worthy objectives.

4 Understanding International Energy Trade and Investment Through Investor-State Arbitral Awards

Arbitral awards shed insight into how IIAs can or potentially could shape international energy trade. The reach is expansive. The awards also demonstrate the extent to which international energy trade implicates sustainable development.

4.1 Investment

As a threshold matter, what aspects of international energy trade constitute an investment under the applicable IIA? Is an investment limited to an investor's presence in a host state through a physical investment, such as an extractive facility, refinery, or pipeline? Or could less tangential ties, such as the status of being a shareholder in a company, elevate the shareholder to the privileged status of investor and thus enable it to benefit from the investment protection promises under the treaty?

[43]Foster (2013), pp. 398–405.

[44]Vienna Convention on the Law of Treaties, art. 31(3)(c), 23 May 1969, 1155 U.N.T.S. 331.

[45]See UN ILC Fragmentation Report (2006), para. 420.

Under a number of IIAs, tribunals have accepted that energy infrastructure satisfies the treaty investment requirement. For example, in ***AES Summit Generation Ltd. & AES-Tisza Erőmű KFT v. Hungary*****,**[46] an ICSID tribunal exercised jurisdiction over the claim of a UK corporation and a Hungarian corporation, 99 % owned by the UK entity, arising out of Hungary's pronouncement of price decrees that adversely affected investment in an electrical supply station. Or, as another example, Venezuela's enactment of measures affecting foreign-owned oil production and development facilities prompted arbitral tribunals to exercise jurisdiction as to the foreign investors' claims under a variety of BITs.[47] One of the more notable cases is the $1.7 billion award in favor of Occidental Petroleum against Ecuador arising out of the latter's termination of a participation contract to explore and exploit hydrocarbons.[48] Such investments, ownership of supply stations and production and development facilities and interests in exploration contracts, fit squarely within the traditional notion of an investment and thus there is nothing surprising about their being protected under IIAs.

Second, investors from a State Party that own shares in companies engaged in such activities also benefit under certain treaties, such as the ECT. In ***Plama Consortium Ltd. v. Bulgaria*****,** the tribunal recognized that a shareholder was entitled to assert a claim under the ECT as the company in which it held shares did business in one of the ECT countries, Bulgaria.[49] The rationale is that under the ECT, an investment is defined to include "'any right conferred by law or contract.'"[50]

Third, investment has been extended to financial products relating to energy. In ***Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka*****,** an ICSID tribunal held that a hedging agreement between Deutsche Bank and Sri Lanka's Ceylon Petroleum Corporation (CPC) is an investment under the Germany-Sri Lanka BIT.[51] The hedging agreement was designed to protect the CPC from the adverse impact of an increase in oil prices.[52] Under the BIT, an investment included "claims to money which has been used to create an economic value or claims to any performance having an economic value and associated with an investment."[53]

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[46] AES Summit Generation Ltd. AES-Tisza Erőmű KFT v. Hungary, ICSID Case No. ARB/07/22, Award (Sept. 23, 2010).

[47] See, e.g., ConocoPhillips Petrozuata B.V. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/30, Award (Sept. 3, 2013); Mobil Corp., Venezuela Holdings B.V. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/27, Decision on Jurisdiction (June 10, 2010).

[48] Occidental Petroleum Corporation v The Republic of Ecuador, Award, ICSID Case No. ARB/06/11 (Oct. 5, 2012).

[49] Plama Consortium Ltd. v. Rep. of Bulgaria, ICSID Case No. ARB/03/24, Decision on Jurisdiction (Feb. 8, 2005), para. 128.

[50] *Id.*

[51] Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka, ICSID Case No. ARB/09/2, Award (Oct. 31, 2012).

[52] Deutsche Bank Award, para. 14.

[53] Deutsche Bank Award, para. 218 (quoting Article 1(1) of Germany-Sri Lanka BIT).

According to the tribunal, the hedging agreement was an asset with economic value to Deutsche Bank, which met the definition of an investment under the BIT.[54] Under the treaty, the investment must have a territorial nexus to Sri Lanka, which was satisfied even though important work on the agreement was done outside of Sri Lanka. The nature of modern banking is that international banks have branches and subsidiaries around the world and work may be done on transactions in multiple places; the key was that "the funds paid by Deutsche Bank in execution of the **Hedging Agreement** were made available to Sri Lanka, were linked to an activity taking place in Sri Lanka and served to finance its economy which is oil dependent."[55] As a result, the IIA applied to a contract involving energy trading with ties to a number of countries. Such a conclusion is almost counter-intuitive as the energy trader, such as a bank, has no ownership in the underlying asset, oil. Instead, it acts more like a market-maker.

Given the broad definition of investment under many IIAs, and the tribunals' fairly consistent, liberal interpretations of the term, it is indeed possible that any form of financial consideration, such as the purchase of a bond used to finance a publicly-financed energy facility, would allow the bond-holder to invoke the investment protection measures under the IIA and serve to open the door to the arbitration arena.[56]

4.2 State Measures and the Investment/Investor

Alleged acts of the Host State must have the requisite relationship to the investor or investment as set forth under the applicable IIA. For example, in one of the first investor-state cases in the energy area, ***Methanex v. United States***, a Canadian investor claimed that California's ban of an additive in gasoline, MTBE, and methanol constituted discriminatory treatment in violation of the NAFTA.[57] Under NAFTA Article 1101(1), the State's measures must "relate to" the investor or investment in the territory of the State.[58] The tribunal found that the investor had "failed to establish that the US measures were intended to harm foreign methanol producers (including Methanex) or benefit domestic ethanol producers" and thus, "there is no legally significant connection between the US measures, Methanex and

[54]Deutsche Bank Award, para. 285.

[55]Deutsche Bank Award, paras. 291–92. The tribunal also recognized that "the preliminary engagement took place in Sri Lanka and it is there too that the investment had its impact." *Id.* para. 291.

[56]See Abaclat v. Argentine Republic, ICSID Case No. ARB/0715, Decision on Jurisdiction and Admissibility (Aug. 4, 2011) (bond-holders are investors).

[57]Methanex v. United States, Award (May 23, 2005), 44 I.L.M. 1345.

[58]NAFTA Art. 1101(1).

its investments."[59] While the case received considerable attention as it was the first to examine the tension between the investor-state regime and the State's ability to regulate to protect the environment, its holding established a fairly narrow window for challenging a regulation. In another NAFTA Chap. 11 case involving Canada's restriction of another gasoline additive, however, the tribunal took a broad approach and recognized that the restriction fit within NAFTA Chap. 11.[60]

The ECT extends beyond that of NAFTA as it expressly recognizes that each State Party "shall ensure that any state enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party's [investment protection] obligations".[61] In other words, under the ECT, the State measure could arise from the acts of a state enterprise.

4.3 State Measures Subject to Review

The number of investor-state cases that raise international energy trading issues has increased in recent years. A detailed analysis of them is beyond the scope of this paper, but cases can be put into certain categories. They are as follows:

4.3.1 Direct State ban on energy activity: the most prominent of these cases is *Vattenfall*, in which a Swedish-state owned company has brought a claim against Germany arising out of its phase-out of nuclear energy. Another high profile case is ***Lone Pine Resources, Inc. v. Canada***, in which an investor in shale gas faced an outright ban by the Government of Quebec on exploration due to citizens' concerns about environmental consequences.[62]

4.3.2 Elimination of State support for alternative energy development: recent cases in this area involve numerous ones against European countries that have eliminated the ability of solar energy investors to pass on the costs of solar technology to consumers by charging above-market prices or to require them to pay a tax on solar power profits.[63] A request to consolidate the ones against the Czech Republic is pending.

4.3.3 Other currency or pricing regulations. Due to economic needs, a State may issue currency or pricing regulations that devalue the investment. The most notable of these is Argentina's enactment of the Public Emergency and Foreign Exchange System Reform Law in 2002, which required that public

[59]Methanex Award, Part IV-Chapter E, para. 22.

[60]Ethyl Corp. v. Canada, UNCITRAL Arb., Decision on Jurisdiction (June 24, 1998).

[61]ECT Art. 22(1).

[62]Lone Pine Resources Inc. v. Canada, Notice of Arbitration, UNCITRAL Arb. (Sept. 6, 2013).

[63]See, e.g., Photovoltaik Knopf Betrievs-GmBh v. Czech Republic, UNCITRAL Arb. (2013); CSP Equity Investment S.a.r.l. v. Spain (2013).

contracts, including those with foreign investors in the energy sector, be paid in pesos.[64]

4.3.4 Environmental restrictions. States routinely enact restrictions on multiple aspects of energy trade due to environmental concerns. Examples are the *Methanex* and *Ethyl* cases, in which additives to gasoline were banned. Although not all-out bans, these regulatory measures, many of which are routine and what a reasonable person would expect be part of a State's governance function, could be considered a taking of the investment.

Each case could present a conflict between sustainable development and energy, a matter that comes within a sovereign's regulatory power. In *Lone Pine*, a local government elected to ban an exploration form that it deemed was environmentally unsound. As for solar energy, the investors' objective of providing an environmentally-friendly, renewable source of energy, which the State had promoted and endorsed in the first instance, was undermined due to a sudden economic downturn. The price cases, such as those emerging from the economic crisis in Argentina, address a number of issues, including the critical one of whether an economic emergency is sufficient to excuse Argentina's performance under an IIA. And the regulation cases may challenge State efforts to address practices deemed harmful to the environment.

5 Reconciling International Energy Trade and Sustainable Development

Accepting that IIAs and the regime within which disputes arising under them have no room for arguments based on sustainable development would be misguided. Such a view assumes that international environmental norms and principles are irrelevant to the treaties, which are largely governed by international law. Admittedly, the treaties may not expressly allow environmental norms to dictate the result of an investor's claim. Nevertheless, the norms could be relevant.

This author has already argued that tribunals have a range of tools to address human rights concerns arising in investor-state disputes.[65] These principles could also apply to sustainable development issues.[66] The first principle is that a

[64] See, e.g., *S*empra Energy Int'l v. Argentine Republic, ICSID Case No. ARB/02/16, Award (Sept. 28, 2007) (later annulled); Enron Corp. Ponderosa Asset, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3, Award (May 22, 2007) (later annulled); CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, Award (May 12, 2005).

[65] Karamanian (2012, 2013).

[66] Arguments in this section, along with citations, are based on the author's analogous arguments in the human rights context. Karamanian (2013), pp. 436–438, 442–446. The text in this essay uses some of the text and footnotes from this earlier work yet it analyzes the principles in the context of sustainable development versus exclusively human rights, which was the focus of the earlier work.

sustainable development norm rising to a ***jus cogens*** norm should trump IIA obligations. The second principle is that IIAs should be interpreted under VCLT, Article 31(1) to give full effect to their purpose as reflected in the preambles and exceptions provisions and in light of customary international law. The third principle is that sustainable development aspects of the investment protection measures and necessity clauses in the treaties should be recognized and given effect.

5.1 Jus Cogens *Trumps IIA Obligations*

VCLT, Article 53, recognizes a *jus cogens* norm as one "accepted and recognized by the international community of States as a whole as a norm from which no derogation is permitted."[67] A treaty cannot avoid *jus cogens* obligations, "the most fundamental rules of protection of human rights, like investments made in pursuance of torture or genocide or in support of slavery or trafficking of human organs."[68] These obligations are mandatory.[69]

A tribunal could invoke the first principle to protect sustainable development principles that rise to *jus cogens* even if doing so would be inconsistent with a treaty's investment protection measures.[70] The outcome, however, sheds a little light on the interaction between sustainable development and investment norms as the IIA would not protect the aggrieving investor.[71] In this sense, the State would use the *jus cogens* principle as a defense to the investor's claim.[72] Thus, the investor could not prevail on its claim against the Host State arising under the treaty.

What *jus cogens* norms could be used affirmatively in an investment dispute? The tribunal in *Phoenix Action* referred to investments in furtherance of genocide, slavery, or piracy. One could add crimes against humanity.[73] Other possible additions include investments that deprive an indigenous community of its sacred

[67] VCLT Art. 53.

[68] Phoenix Action Ltd. v. Czech Republic, ICSID Case No. ARB/06/05 Award (Apr. 15, 2009) para. 78. See also Methanex Award, Part IV, Chap. C, para. 24 ("as a matter of international constitutional law a tribunal has an independent duty to apply imperative principles of law or jus cogens and not to give effect to parties' choices of law that are inconsistent with such principles").

[69] Bjorklund (2007), pp. 199–202; Choudhury (2011), pp. 677–678.

[70] See Simma and Kill (2009), pp. 678, ("jus cogens norms impose a 'legally insurmountable limit to permissible treaty interpretation'" (quoting *Oil Platforms (Iran v USA)*, Merits, Judgment, Nov. 6, 2003, *ICJ Reports* (2003) 161, 330, para. 9 (Separate Opinion of Judge Simma)).

[71] Wythes (2010), p. 252 (citing Peterson LE & Gray K (2003) International Human Rights in Bilateral Investment Treaties and Investment Treaty Arbitration. International Institute for Sustainable Development, Manitoba, Canada).

[72] See Phoenix Action, Award; see also Stephan (2011), pp. 1101–1103; Shaffer and Trachtman (2011), p. 128 (noting in the context of the WTO that a customary human rights law norm could be invoked as a defense).

[73] Brownlie (1998), pp. 516–517.

property, which perhaps could fit within the sustainable development framework. Thus, certain investment activity would not be afforded treaty protection due to the priority of sustainable development. That said, international environmental law per se has not evolved to pronounce *jus cogens* norms so application of the principle would be quite limited. New arguments relating to the human right to a healthy environment, however, could perhaps shape such norms.

A State could argue that its conduct is protected under *jus cogens* principles. For example, a State may argue that it nationalized an investment consistently with international law and was compelled to do so to protect the environment or simply to exercise its inherent right to control its resources. Another example would be a State's regulation of nuclear power when the power could be seen as directly leading to substantial loss of life. Leading arbitration scholars have asked whether nationalization is a *jus cogens* right.[74] Andrea Borklund, citing *Methanex* and decisions of the Inter-American Court of Human Rights, has noted that race discrimination perhaps rises to a *jus cogens* violation.[75] Yet, the desire of a State to eliminate race discrimination could be the basis for the State action allegedly giving rise to breach of the investment treaty, as in *Foresti v. South Africa*, which involved a mining investment.[76] Thus, *jus cogens* could be asserted defensively in support of the challenged State conduct.

The proposed approach faces challenges beyond the uncertainty about *jus cogens* or the difficulty of applying the norms to a specific dispute. The first sentence of VLCT Article 53 provides that "[a] treaty is void if, at the time of its conclusion, it conflicts with a preemptory norm of general international law." In other words, it speaks of treaty validity, not use of *jus cogens* as a defense to the position of a party to the treaty. Second, the *jus cogens* norm must conflict with the treaty when the treaty is concluded. In using *jus cogens* as a defense to the investor's conduct the state would be arguing about events occurring after the treaty was in effect. Yet, even the International Court of Justice in the *Jurisdictional Immunities* case has recognized that "[a] jus cogens rule is one from which no derogation is permitted" although such a rule would not apply to "the scope and extent of jurisdiction."[77] Hence, under the proposed first rule, an investor-state tribunal could rely on *jus cogens* in a defensive way.

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[74]Bishop, Crawford & Reisman (2005), p. 916; El Paso Energy Int'l Co. v. Argentine Republic, ICSID Case No. ARB/03/15, Award para. 168 (Oct. 31, 2011) (noting that Professor Sornarajah has argued that permanent sovereignty over natural resources is a principle of *jus cogens*).

[75]Bjorklund (2007), p. 201.

[76]Foresti v. South Africa ICSID Case No. ARB(AF)/07/01 (Nov. 1, 2006), Request for the Registration of Arbitration Proceedings.

[77]Jurisdictional Immunities of the State (Ger. v. It.), Judgment, para. 95 (Feb. 3, 2012). Stephan (2011), p. 1077.

5.2 *Applicable Interpretive Standard*

A tribunal should interpret the IIA "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."[78] The context of the treaty includes its text, preamble, and annexes.[79] The text of some IIAs, while not explicitly mentioning environmental or sustainable development norms, includes language within which they could fit. For example, many IIAs refer to areas that are exempt from a claim of indirect expropriation as they are an exercise of the state's police powers. The exempt areas are typically ones that are "designed and applied to protect legitimate **public welfare** objectives."[80] A tribunal must inquire as to the state's motives in regulating or acting and whether there is a public welfare component to the practice as well as the effect of the state practice. As one tribunal described, the "context within which an impugned measure is adopted and applied is critical to the determination of its validity."[81] States have duties under treaties to protect and promote the environment so a state that enacts non-discriminatory laws consistent with those duties surely would be undertaking to protect the legitimate public welfare.[82] Such an interpretation would be consistent with the **UN Guiding Principles on Business and Human Rights**, approved by the UN Human Rights Council, that encourage states to be able to regulate to protect human rights, which include labor issues and affected local communities[83] and also with the 2011 **OECD Guidelines for Multinational Enterprises**, which recognize the state's duty to protect the environment and the obligation of enterprises to do the same.[84] Clearly, the ECT's reference to sustainable development also sets the appropriate benchmark at least for cases filed under that treaty.

An additional reason for applying a broad definition of public welfare rests in the text of the IIA, such as explicit references to the relationship between investment and non-investment activities and the need for the latter to be protected. For example, under the 2012 US Model BIT, states recognize that investment should not be encouraged at the cost of weakening or reducing the protections of domestic environmental laws.[85] The NAFTA similarly provides that "it is inappropriate

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[78]VCLT Art. 31(1). See also McLachlan (2008), pp. 383–385; Choudhury (2011), pp. 705–712.

[79]VCLT Art. 31(2.)

[80]See note 29 and accompanying text.

[81]Saluka Investments BV v. Czech Republic, Partial Award (Mar. 17, 2006), para. 264 (Saluka Award).

[82]See, e.g., Krommendijk and Morijn (2009), pp. 435–436 (promotion and protection of human rights would fit within police powers clauses in BITs); Choudhury (2011), p. 791.

[83]UN High Commissioner on Human Rights (2011) I.A.2; see also I.B.3 (states should ensure that their laws and policies "enable business respect for human rights" and that they enforce such laws).

[84]OECD Guidelines (2009) sec. IV and commentary.

[85]2012 US Model BIT Arts. 12, 13.

to encourage investment by relaxing domestic health, safety or environmental measures."[86] The 2012 US Model BIT reaffirms a commitment to the obligations of the **International Labor Organization**.[87] Under the VCLT, the treaty terms are to be examined in the context of the language of the treaty.[88] Again, the ECT language is highly relevant. Thus, a tribunal should give effect to the phrase "public welfare" in light of other public values recognized in the treaty.

Under the VCLT, tribunals can also consider the language of preambles to investment treaties. In certain treaties, the preambles recognize that the investment objectives should be achieved in a manner consistent with sustainable development and protection of health, safety, the environment, and labor rights.[89] This language does not create independent obligations but it can be used to shed light on the meaning of the investment protection measures. As the tribunal in ***Grand River Enterprises Six Nations, Ltd. v. United States*** observed:

> . . . NAFTA involves a balance of rights and obligations, and does not point unequivocally in a single direction. While NAFTA's preamble speaks of promoting investment, it also affirms the need to preserve the NAFTA Parties' 'flexibility to safeguard the public welfare.'[90]

This analysis is consistent with the award in *Saluka Investments* in which it was recognized that the substantive provisions of the treaty must be balanced with the treaty objectives as reflected in the preamble.[91]

5.3 Investment Protection and Sustainable Development

The third rule is that broad principles of sustainable development could elucidate IIA's investment protection provisions and a State's defenses. The norms are likely relevant only if international law applies to disputes arising under the treaty. The investment protections in the treaties may reflect customary international law[92] so interpreting them could be considered as giving effect to custom within the context of specific treaty language. Either party to the treaty or the tribunal could invoke the norms, along with *amicus curiae,* if allowed under the arbitral rules, so long as the norms do not create new duties or defenses beyond those in the IIA.[93] This approach is consistent with what former ICJ Judge Bruno Simma and Theodore

[86]NAFTA Chap. 11 Art. 1114(2).

[87]2012 US Model BIT Art. 13(1).

[88]Methanex Award, Pt. II, Chap. B, para. 16.

[89]See notes 25–26, 31–32 and accompanying text.

[90]Grand River Enterprises Six Nations, Ltd. v. United States, UNICTRAL Arb., Award para. 69 (Jan. 12, 2011).

[91]Saluka Award, para. 300.

[92]Alvarez (2009), p. 33.

[93]See Simma and Kill (2009), p. 692.

Kill have noted as a "presumption that the parties to a treaty did not intend to upset some other rule of international law."[94]

For example, sustainable development norms could give effect to the meaning of the fair and equitable treatment clause or the State's obligation to afford the customary international law minimum standard of treatment of aliens to the investment. A fair and equitable treatment clause may be along the following lines:

> Each Contracting Party shall ensure fair and equitable treatment of the investments of nationals of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals. Each Contracting Party shall accord to such investments full physical security and protection.[95]

A stand-alone clause like this, while not specific in its terms, has been recognized as imposing obligations of legitimate expectations, non-discrimination, fair judicial and administrative process, transparency, and proportionality.[96] These obligations do not exhaust the full meaning of the concept but they give it some definition. Or, another form of the clause makes explicit reference to international law, such as NAFTA Chap. 11 Article 1105(1) and ECT Article 10(1). The **customary international law minimum standard** applies to an act that is "sufficiently egregious and shocking – a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons."[97] The clauses are "vague general clauses" that could be "gateways for the integration of arguments based on norms of other spheres of the international legal system."[98]

To be sure, the fair and equitable clauses are not open doors for any argument of investors, including ones that fit within the rubric of sustainable development, that the State conduct is unfair or inequitable, and the same would hold true for the state's assertion of a defense.[99] The conduct must relate to the investment. Second, a tribunal should proceed only if sustainable development arguments fit within the recognized areas as the basis of protection. Or as to claims under NAFTA Article 1105(1) the conduct must rise to a fairly high level as set out in *Glamis Gold*. A tribunal is not at liberty to wholesale adopt sustainable development norms into the fair and equitable clause but it could address them when they are affected by the dispute at issue and give the appropriate weight to them in a reasoned manner. Such an approach is consistent, for example, with UNCTAD's observation that fair and equitable treatment depends on the level of development of the host country.[100]

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[94]Simma and Kill (2009), p. 694.

[95]Netherlands-Suriname Agreement on encouragement and reciprocal protection of investments (2006) Art. 3(1), http://investmentpolicyhub.unctad.org/Download/TreatyFile/2085 (last visited Jan. 30, 2016).

[96]Kläger (2011), pp. 117–119.

[97]Glamis Gold Ltd. v. United States, UNCITRAL Arb., Award (June 8, 2009) para. 616.

[98]Kläger (2011), pp. 117–119.

[99]Knoll-Tudor (2009), p. 319.

[100]UNCTAD (2012), p. 34.

5.4 Application of Interpretive Rules

To illustrate the approach, assume that a State engaged in conduct as to an international energy trade investment that was not transparent, which, in turn, caused a lack of any semblance of predictability and fostered corruption. Such action could be at odds with sustainable development in light of the Delhi Principles.[101] What weight should a tribunal give to an investor's argument that the lack of transparency is a denial of fair and equitable treatment of the investment? First, a tribunal should ask if the IIA contains obligations regarding transparency so it need not take the extra step to find the duty beyond the text of the treaty. Second, if the treaty is silent, the investor still has available to it arguments within the investment context that support a claim of violation of the fair and equitable requirement as to lack of predictability and corruption. Those arguments could be buttressed by reference to non-investment jurisprudence. Professor Thomas Wälde did so in citing to jurisprudence of the European Court of Human Rights in establishing the principle of legitimate expectations as to the treatment of foreign investment.[102] His analysis buttressed the legal conclusion that legitimate expectations fit within NAFTA Chapter Article 1105(1).

Or, as another example, the State could argue that sustainable development principles support its position. For example, in defense of a major energy company's claim of expropriation arising from reforms in tariffs and subsidies, Argentina argued that its actions were justified due to a state of necessity.[103] But the investor has a right to property and that right is grounded in development principles too.[104] What weight, if any, should the tribunal give to Argentina's defense? Again, the tribunal must follow the treaty text. Also, it needs to understand the purpose of the alleged expropriation so the state action can be put in context. One of the first inquiries is the specific clause protecting against expropriation and whether it allows for exceptions based on legitimate aims such as allowing for sustainable development. As noted previously, this clause gives the tribunal leeway to examine non-investment considerations and also to consider them in light of the investment protection obligations. Second, does the treaty have a specific provision to defend the state's actions? For example, the United States-Argentina BIT, Article XI, provides that the treaty "shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests."[105] As Professor

[101] Office of the United Nations High Commissioner for Human Rights (2007) Good Governance Practices.

[102] International Thunderbird Gaming Corp. v Mexico, UNCITRAL Arb, Separate Opinion of Thomas Wälde (Jan. 26, 2006) para 27.

[103] See Sempra Energy Int'l v. Argentina, ICSID Case No ARB/02/16, Award (September 28, 2007).

[104] See Karamanian (2012), pp. 240–242.

[105] US-Argentina BIT Art. XI.

Barnali Choudhury has observed, broad exception clauses give leeway to a tribunal and enable it to consider non-investment principles.[106] Article 25 of the **International Law Commission's Articles on Responsibility of States for Internationally Wrongful Act** could also enable a defense based on sustainable development as shaping the contours of necessity.[107] Any treaty or customary standard that promotes sustainable development, however, must be balanced against the investment protection measure at issue. Such a balance can occur by inquiring critically into the State action and assessing the options available to the State, short of breaching the investment treaty, to protect sustainable development.

6 Conclusion

Although investors in international energy trade may benefit from the investment protections in IIAs, they are not given a carte blanche to act in a manner inimical to sustainable development. Host States, as well, are not given a license to shirk sustainable development principles merely due to the IIAs. The treaties and the international legal regime in which they operate have some built-in protections as this essay has addressed.

Nevertheless, the system is far from certain and predictable. Arbitrators have tools to dissect arguments and they are afforded relative flexibility in assessing the arguments so that it is indeed possible for them to stray from the values embedded in sustainable development. The text of IIAs, while in certain situations referencing sustainable development or related principles, does not impose clear duties based on the concept. As a result, while the system has benefited from a measured and studied approach by most of the tribunals, it is not ideal. The lack of clarity runs both ways-investors and States would be better served with more defined obligations and a better understanding of the corresponding benefits arising from them.

One obvious challenge is that sustainable development is a broad term. Yet it is fairly well-recognized that the concept includes certain elements, such as preventing extreme environmental degradation, preventing poverty and hunger, and public participation. Hence, if a treaty references sustainable development, a more specific delineation of aspects of it rather than use of the general term would be beneficial. This approach should recognize, however, that even specific elements could be considered open-ended and subject to interpretation consistent with the Vienna Convention on the Law of Treaties and other interpretive standards required under the treaty.

[106]Choudhury (2011), p. 711. The recent award in Philip Morris Brands SARL v. Uruguay, in which the tribunal recognized that it was within Uruguay's police power to regulate against advertisements on tobacco packaging is consistent with this approach. Philip Morris Brands SARL et al. v. Oriental Republic of Uruguay, (ICSID Case No. ARB/10/7), Award (July 8, 2016), paras. 287–291.

[107]UN ILC State Responsibility (2001) Art. 25

Second, how should a treaty address the relevant elements? Agreeing on new treaty language could be challenging. Text that carves out from investment protection specific conduct is one such approach. Also, affirmative obligations could be imposed on the investor and the State. Indeed, this angle is already being pursued with regard to transparency in the investor-state process. Or affirmative duties could be imposed on the investor, such as taking specific environmental concepts set out in the ECT, which are recognized as State duties, and imposing them as obligations of foreign investors and requiring proof of their satisfaction before investing, or surely before pursuing an arbitration claim.

Finally, considerable action could be taken outside of the treaty sphere. If the aim is to balance exploration, production and transportation of the world's energy resources and other societal goals, including sustainable development, more work needs to be done in buttressing legal regimes of Host States. In this regard, IIAs are not the problem but more a reflection of domestic legal systems in need of reform. And if this is the case, then IIAs could be used, if structured appropriately, to help meet that goal.

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Chapter 19
Comment to "International Energy Trade and Investor-State Arbitration"

Shotaro Hamamoto

Abstract This comment discusses the relationship between human rights concerns and investment treaties.

Keywords Human rights and investment • *jus cogens* and investment

On 2 June 2015, a group of UN human rights experts led by Mr Alfred de Zayas, Independent Expert on the promotion of a democratic and equitable international order, issued a statement to express concern about international investment law:

> There is a legitimate concern that both bilateral and multilateral investment treaties might aggravate the problem of extreme poverty, jeopardize fair and efficient foreign debt renegotiation, and affect the rights of indigenous peoples, minorities, persons with disabilities, older persons, and other persons leaving in vulnerable situations. [. . .] Investor-state-dispute settlement (ISDS) chapters in BITs and FTAs are also increasingly problematic given the experience of decades related arbitrations conducted before ISDS tribunals. The experience demonstrates that the regulatory function of many States and their ability to legislate in the public interest have been put at risk. We believe the problem has been aggravated by the "chilling effect" that intrusive ISDS awards have had, when States have been penalized for adopting regulations, for example to protect the environment, food security, access to generic and essential medicines, and reduction of smoking, as required under the WHO Framework Convention on Tobacco Control, or raising the minimum wage.[1]

This is a common criticism frequently raised today against investment treaties and investment arbitration. If it correctly represented the current state of affairs, no one would deny the urgent necessity of a wholesale reform or even a dismantling of international investment law: but is it really so? Quite unfortunately, the UN experts do not refer to any concrete example of arbitral award that "aggravate[d] the problem". Nor they refer to a serious doctorate thesis questioning the so-called

[1] http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16031&LangID=E

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_19

"chilling effect", though it had already been completed and publicly available well before their statement.[2]

Professor Karamanian (2016) are not convinced by the critics and considers that "[a]ccepting that IIAs and the regime within which disputes arising under them have no room for arguments based on sustainable development would be misguided".[3] She first points out that some recent IIAs specify that the investment protection measures be considered in light of other important social objectives.[4] Looking at the examples quoted in her paper, one cannot but agree with her that these treaty languages will not allow relevant IIAs to "aggravate the problem".

Admittedly, this is a relatively recent phenomenon and a large majority of the existing IIAs do not contain such social-friendly provisions. Are these IIAs inimical to sustainable development? Professor Karamanian again replies in the negative. As for the fair and equitable treatment clause, tribunals can refer to non-investment international law rules, for example the European Convention on Human Rights, to interpret it so that considerations on sustainable development are duly taken into account.[5] In this context, the author reminds us of a point that we tend to forget: it is not necessarily investors but often host States that may take acts pernicious to sustainable development. The fair and equitable treatment obligation or the obligation to protect the investor's legitimate expectations then comes into play to help investors and thus to promote sustainable development.[6]

Professor Karamanian then goes on to consider how the expropriation clause is applied in conformity with sustainable development principles. She explains that tribunals are supposed to take a three-step approach: first, they should look at the applicable treaty text to see whether it allows for exceptions based on legitimate aims including sustainable development; second, they should do the same to see whether it contains a specific provision to defend the State's actions; and third, they should consider whether customary international rules on necessity are applicable.

Although this approach is quite reasonable and perfectly logical, the present commentator wonders if there is any theoretical or practical difference between the fair and equitable obligation and rules on indirect expropriation. Note that we are

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[2]Christine Côté, *A Chilling Effect? The impact of international investment agreements on national regulatory autonomy in the areas of health, safety and the environment*, Ph.D. thesis, London School of Economics, February 2014. See also Report of the Independent Expert on the promotion of a democratic and equitable international order, 5 August 2015, U.N. Doc. A/70/285, paras. 41–46, where the Independent Expert speaks of "chilling effect" without examining existing studies antithetical to the Independent Expert's position.

[3]Karamanian, Section 5.

[4]Karamanian, Sections 3.3 and 5.2. *See also* Aikaterini Titi, *The Right to Regulate in International Investment Law*, Baden-Baden, Nomos, 2014.

[5]Karamanian, Section 5.4.

[6]Karamanian, Section 5.4. For the foundation and functioning of the obligation to protect the investor's legitimate expectations, *see* Shotaro Hamamoto, "Protection of the Investor's Legitimate Expectations: Intersection of a Treaty Obligation and a General Principle of Law", *in* Wenhua Shan & Jinyuan Su eds., *China and International Investment Law*, Leiden, Brill/Nijhoff, 2014, pp. 141–169.

now not talking about direct expropriation, i.e. the case of transfer of property rights from the investor to the State. In case of alleged indirect expropriation, i.e. when a tribunal considers whether a measure taken by the host State is “equivalent” or “tantamount” to expropriation, it is often said that “international tribunals has generally applied the sole effects test”,[7] in other words, tribunals refer only to the effect of the measure on the property allegedly expropriated, thus refusing taking into account the purpose or the legitimacy of the measure. However, a closer reading of the relevant arbitral decisions and awards reveals that tribunals, when finding indirect expropriation, always and without exception finds that the measure in question was illegitimate, unfair or inequitable.[8] This coherent line of arbitral jurisprudence is quite comprehensible, as it is theoretically difficult to find any ground on which the host State is legally obliged to pay compensation in cases of *bona fide* use of their regulatory powers. This observation in no way undermines but reinforces Professor Karamanian’s argument that investment treaties are not inimical to principles of sustainable development.

However, the present commentator has some reservations about Professor Karamanian’s argument relating to the use of *jus cogens* in the context of investment law and investment arbitration.[9] I fully agree with her that investments incompatible with the values protected by *jus cogens* norms cannot be protected under international law. However, as pointed out by Professor Karamanian, the incompatibility with *jus cogens* entails far-reaching consequences, i.e. the nullity of the entire treaty (VCLT, Art. 53) or the termination of the entire treaty (VCLT, Art. 64). More importantly, investment treaties do not protect specific economic or industrial sectors. No one would disagree that an investment treaty explicitly listing investments in slavery industry among investments to be protected shall be null and void, but it is difficult to imagine such a treaty in the real world. The problem is therefore how to prevent extending treaty protection to such kind of investments. This is nothing but a matter of treaty interpretation and as Professor Karamanian states, tribunals can refer to non-investment international law rules when interpreting the applicable investment treaty. In fact, in the two cases mentioned by Professor Karamanian, *Methanex* and *Phoenix*, *jus cogens* norms are referred to as a matter of treaty interpretation.[10] To this list, we would add *Continental Casualty v. Argentina*[11] and *Sempra v. Argentina* (annulment).[12] In this respect,

[7] *Burlington v. Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability, 14 Dec. 2012, para. 396.

[8] Shotaro Hamamoto, “Requiem for Indirect Expropriation: On the Theoretical and Practical Uselessness of a Contested Concept”, PILAGG e-series/IA/1, École de Droit, Sciences Po de Paris, 2013, pp. 1–28, at http://blogs.sciences-po.fr/pilagg/pilagg-e-series/. Also available at SSRN: http://ssrn.com/abstract=2666836.

[9] Karamanian, Section 5.1.

[10] Karamanian, Section 5.1.

[11] *Continental Casualty v. Argentina*, ICSID Case No. ARB/03/9, Award, 5 September 2008, para. 261.

[12] *Sempra v. Argentina*, ICSID Case No. ARB/02/16, Decision on the Argentine Republic’s Application for Annulment of the Award, 29 June 2010, para. 197.

jus cogens norms are not different from other "ordinary" international law norms, save that the former would exert more direct influence upon the interpretation of relevant provisions of investment treaties.

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Part VIII
Environmental Issues: Climate Change and Trade/Investment

Chapter 20
Climate Change, Trade, and Investment Law: What Difference Would a Real Responsibility to Protect Make?

Krista Nadakavukaren Schefer

Abstract While scholars and most international policymakers agree that steps should be taken to counter rising temperatures, fierce disagreement remains among states on the precise measures to be taken to achieve this goal and some governments worry about remaining in compliance with their already existing international treaty obligations. Although the literature on technical compatibility of WTO rules and investment treaty provisions with measures to foster low-carbon economies has established that there is room in the international economic law system for taking climate protecting measures, all too often, governments lack the political will to act. This chapter takes up the question of whether a state *must* take any measures to prevent climate change or to respond to its threats, and if so what this positive duty of prevention and response means for IEL regimes.

Keywords Climate change • Low-carbon economy • Responsibility to protect • Sustainable development • Positive duties

1 Introduction

Discussions of international economic law's relationship to environment, resources, and energy are fraught with controversy. The finiteness of the planet's natural assets; the unequal distribution of mineral deposits; the existential need for fuel; and the threat that human productivity poses to the integrity of our ecosystems are inevitable aspects of any trade and investment law debate that addresses how the legal interacts with the physical in today's global economy. But the particular trade and investment law questions raised by climate change are even more prone to debate given the poorly understood mechanisms causing the altered climate and its widespread and serious consequences. While scholars and most international

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_20

policymakers agree that steps should be taken to counter rising temperatures, disagreement remains fierce among states on the precise measures that may be taken and the extent to which governments can support particular economic activities and suppress others without violating their international economic law (IEL) treaty obligations.

Much has been written about the technical compatibility of WTO rules with measures to foster low-carbon economies.[1] The literature addressing investment and climate change has also begun to appear, analyzing what protection can be assured for investors who may have impacts on greenhouse gas emission levels.[2] These analyses are important for establishing the compatibility of individual economic policies with the multilateral legal frameworks now in place, for governments will rarely choose to violate their existing international treaty obligations if they can avoid doing so. This is particularly true for the IEL obligations, where illegality can be effectively sanctioned. Where governments are assured of IEL-complicity, they can go ahead and regulate.

Yet, the slowness of political leaders to agree on binding rules on climate change mitigation suggests that some administrations consider lowering the risks of climate change to be a bigger threat to their own political viability than the long-term benefits to the international community would warrant.[3] It is the political-economic reality of short-term politics, not the potential of violating IEL treaties, that stands in the way of a determined pursuit of the low-carbon society. Governments are

[1]E.g., Panagiotis Demlimatsis, ed., Research Handbook on Climate Change and Trade Law (Edward Elgar, forthcoming); Jeffery Atik, Inventing Trade Remedies in Response to Climate Change, 18 Sw. J. Int'l L. 53 (2011); Bradly J. Condon and Tapen Sinha, The Role of Climate Change in Global Economic Governance 52–91 (Oxford Univ. Press, 2013); Thomas Cottier and Nashina Shariff, International Trade and Climate Change in: Geert Van Calster and Denise Prévost, eds., Research Handbook on Environment, Health and the WTO (Edward Elgar, 2013); Andrew Green, Climate Change, Regulatory Policy and the WTO: How Constraining are Trade Rules? 8:1 J. Int'l Econ. L. 143 (2005); Joost Pauwelyn, Carbon Leakage Measures and Border Tax Adjustments under WTO Law in: Geert Van Calster and Denise Prévost, eds., Research Handbook on Environment, Health and the WTO (Edward Elgar, 2013); Chris Wold, Don Gourlie, and Amelia Schlusser, Climate Change, International Trade, and Response Measures: Options for Mitigating Climate Change Without Harming Developing Country Economies, 46 Geo. Wash. Int'l L. Rev. 531 (2014).

[2]E.g., Lisa Bennett, Are Tradable Carbon Emissions Credits Investments? Characterization and Ramifications Under International Investment Law, 85 NYU L. Rev. 1581 (2010); Anatole Boute, Combating Climate Change Through Investment Arbitration, 35 Fordham Int'l L. J. 613 (2012); Condon and Sinha, supra n. 1, 92–129; Daniel M. Firger and Michael B. Gerrard, Harmonizing Climate Change Policy and International Investment Law: Threats, Challenges and Opportunities in: Karl P. Sauvant, ed., YB on Int'l Investment L & Pol'y 2010–2011 (New York: Oxford Univ. Press, 2012); Kate Miles, Arbitrating Climate Change: Regulatory Regimes and Investor-State Disputes, 1 Climate L. 63 (2010).

[3]See generally, Lord Gibbens, The Politics of Climate Change 2014: What Cause for Hope? (http://www.lse.ac.uk/GranthamInstitute/event/the-politics-of-climate-change-2014-what-cause-for-hope/) (talk given at the London School of Economics setting out why there is so little positive action being taken by governments to slow the accumulation of greenhouse gas emissions despite the growth in scientific evidence of climate change).

unwilling to sacrifice economic growth and competitiveness (often only for the good of distant strangers or future generations) when determining climate-impacting policies. All too often, it is the value of a stable climate that loses in such balancing of interests.

If, then, the IEL community wants to look seriously at the relationship between climate change and trade or investment rules, it cannot ignore the equally important question of whether a state *must* take any measures to prevent climate change or to respond to its threats, and if so what this positive duty of prevention and response means for IEL regimes. This paper takes up these questions.

I have argued elsewhere that there is a concept that could be seen as requiring states to take positive steps to reduce their emission of greenhouse gases as a preventative measure.[4] That is the concept of what I call the strong Responsibility to Protect (R2P*). This stronger version of the state's obligation to respond to serious threats extends the scope of Responsibility to Protect (R2P) as it has been defined by the UN by taking the idea of human security more seriously – both in its realization that: (1) dangers to individuals originate not only from horrific mass crimes but also from natural or human-induced catastrophes; and in (2) its mandate requiring positive action by states to address situations where suffering is likely, is occurring, or has occurred. The implications of R2P* for the WTO system, I suggest, are such as to remove the discretion Members have in implementing trade liberalizing measures to promote climate friendliness.[5] Moreover, the strong duties of R2P*could even be interpreted to require taking climate-change mitigating actions that violate specific WTO rules if the benefit of such actions to human security outweigh the benefits that arise from adhering to *pacta sunt servanda* in a particular case.

The present paper will take up the R2P* idea and apply it to investment law. Sharing the background belief in the benefits of economic growth and liberalization's contribution to that growth, investment law rules are distinguishable from trade rules in their protection of individual investors.[6] Looking at an individual's advantages rather than a nation's shifts the balance of interests that states are called to consider in IEL. Nonetheless, the normative effect of R2P*'s call for active protection of the population's welfare remains.

Section 2 briefly sketches out the concept of climate change as an issue for states' responsibility to protect the world's populations. Section 3 assesses investment law as a regime of positive state duties. Section 4 looks at how R2P* would alter the investment law obligations of states. Section 5 concludes.

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[4]Krista Nadakavukaren Schefer and Pablo Arnaiz, Duties to Protect, Climate Change, and Trade in: Panagiotis Delimatsis, ed., Research Handbook on Climate Change and Trade Law (Edward Elgar, *forthcoming*).

[5]Nadakavukaren/Arnaiz, supra n. 4.

[6]Nadakavukaren/Arnaiz, supra n. 4.

2 Climate Change as an Issue for R2P*

Addressing the truly global phenomenon of climate change has become one of the world's most pressing challenges. Placed as Goal 13 in the UN's Sustainable Development Goals (the follow-up to the Millennium Development Goals), climate change is officially a global matter of concern.[7] States have accepted the anthropogenic nature of climate change. Governments recognize that climate change will have disastrous consequences for some populations. The United Nations (UN) has warned of extreme weather, food shortages, flooding, and disease. Moreover, many of those populations who are most likely to face disadvantageous changes in the local environment are those who have the least resources with which to adapt to these changes. As a result, state leaders have agreed to cooperate on negotiating about obligations to reduce greenhouse gas emissions in the future. And yet, states have been slow to accept binding obligations to actually *do* anything about the continued rise in atmospheric temperatures.[8]

The core problem with accepting obligations to reduce climate change is the fundamental political unwillingness of individual governments to commit to actions that will be costly and/or which will reduce the competitiveness of domestic industries. On the national and local level, this is as true as it is on the international level, although the justification voiced for "bystanding" may differ.[9] A study of climate change inactivity in the United States explains the political situation there:

> ... local 'carbon management' efforts are being constrained by the absence of effective federal government action. Such ineffectiveness or 'bystanding' is not accidental. For the American conservative movement, 'non-decision making' (rather than overt resistance) is the primary climate change strategy, while more broadly a deliberately noninterventionist response aligns with the still-dominant political philosophies of neoliberalism, ecological modernization, and free-market environmentalism.[10]

Internationally, resistance may be voiced as to the "unfair" nature of having to accept the costs of action – either because that particular state did not contribute to

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[7]The Sustainable Development Goals are found in the Report of the Open Working Group on Sustainable Development Goals. See A/68/970, 12 August 2014. The General Assembly acknowledged the Report and declared that it will be "the basis for integrating sustainable development goals into the post-2015 development agenda". UNGA, Draft resolution submitted by the President of the General Assembly, A/68/L.61, 8 September 2014.

[8]The Framework Convention on Climate Change's COP 20 in Lima resulted in a "Call for climate action" which contains an annexed draft text of a binding agreement to address climate change. Decision-/CP.20. That the Call is hortatory and distinctly non-committal (noting, for example, in paragraph 8 that "arrangements specified in this decision in relation to intended nationally determined contributions (INDCs) are without prejudice to the legal nature and content"), the openness of the draft agreement text also underlines the lack of governmental will to act decisively.

[9]Lauren Rickards, John Wiseman, and Yoshi Kashima, Barriers to effective climate change mitigation: the case of senior government and business decision makers, WIREs Clim Change 2014, doi: 10.1002/wcc.305 (viewed 27 January 2014).

[10]Rickards, Wiseman, and Kashima at p. 2 (footnotes omitted).

the current high levels of greenhouse gases (GHGs) in the atmosphere or alternatively because the state does not want to burden itself while current (or future) GHG emitters continue to profit from not being bound to reductions. Yet, it is important to recognize the similarity to the non-decision making attitude taken by some national political parties, for here, too, the resistance is not fundamentally a fear of acting illegally in taking on such duties. Rather, it is an unwillingness to actively pursue the goal of GHG reduction.

Political unwillingness is a widespread challenge to ensuring the well-being of a community. Where individual interests are not served, members will rarely act in the community interest without moral or legal pressure to do so. Indeed, where individual interests are likely to be *harmed* by protection of the common good, even substantial moral pressure may fail to outweigh a legally permissible preference for inaction. In the climate context, the failure to act is pointed to as an example of the "ecological paradox", or "'the curious simultaneity of an unprecedented recognition of the urgency for radical ecological political change, on the one hand, and an equally *unprecedented unwillingness* and inability *to perform such change*, on the other'".[11]

This paradox of recognizing the "urgency for ... change" while demonstrating an "unwillingness ... to perform such change" is precisely the problem that the quasi-legal concept of Responsibility to Protect was originally designed to overcome. In the case of Responsibility to Protect (R2P), the paradox was humanitarian. When, in 1994, the international community watched the ethnic tensions in Rwanda escalate into a brutal massacre of the Tutsi population, it recognized the genocidal potential – the legal prerequisite for humanitarian intervention. As the genocide materialized, and with it the legal justification for intervention, the UN and the world's most powerful governments continued to do nothing. The right to intervene, it was clear, was not sufficient to rescue the 500,000 Rwandans facing brutality of the highest order from their own government. Unwillingness to make use of the right to intervene was the barrier to humanitarian rescue, not illegality.

In the aftermath of Rwanda, the International Commission on Intervention and State Sovereignty (ICISS) was formed to examine when the moral legitimacy of humanitarian intervention makes changes the legal nature of intervention from being a violation of a fundamental principle of international law (the principle of territorial sovereignty) into a duty owed to the suffering population. The ICISS members submitted their work-product in the form of a report titled "The Responsibility to Protect".[12] The title was chosen carefully – the specific phrase "responsibility to protect" was intended to emphasize that the concept was to be a paradigm shift away from the contemporary view of sovereignty as rights, to a new view of sovereignty: sovereignty as responsibility.[13]

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[11]Id. (citing I. Blühdorn, The politics of unsustainability: COP15, post-ecologism, and the ecological paradox. O*rgan Environ* 2011, 24:34–53).

[12]ICISS, The Responsibility to Protect (Ottawa: International Development Research Center, 2001).

[13]ICISS, The Responsibility to Protect, supra n. 12, paras. 2.28–2.33.

An obligation of protection under the R2P framework includes three duties – the duty to prevent the realization of the threat, the duty to protect from the effects of the threat, and the duty to rebuild lives after the threat has ceased to exist.[14] As set forth by ICISS, these duties have two other aspects of particular importance. First, each state has such responsibilities toward its own population. Where the state itself is unable or unwilling to supply the requisite protection, the international community has a responsibility to provide it.[15] There has been much written about the precise definition of this secondary obligation of the international community, but the primary focus must be on the fact that R2P demands *action* be taken to protect populations. The question of *who* provides the protection is secondary to this. It is the needs of the sufferers that is paramount to the fulfilling of R2P's conceptual goals. There is therefore no option of relying on a sovereign right to remain passive in the face of massive human suffering.

Second, the scope of threats to which R2P applies is determined by what one considers to be the focus of the principle. While later concretizations of R2P by the UN have limited the scope of the duty for action to the four discrete situations of genocide, crimes against humanity, war crimes, or ethnic cleansing,[16] the original view was more expansive. Taking the centrality of human suffering as a focal point, the ICISS conception would have founded legal duties to protect and rescue populations on a variety of threats – natural as well as manmade. Where an epidemic or a failed harvest or even severe impoverishment threatens a large number of people, a victim's-centered concept such as R2P could not logically be excluded.[17]

Nevertheless, the Secretary General's 2009 report on R2P implementation explicitly denies the extension of R2P to contexts of suffering other than the four crimes listed above[18] and the General Assembly's text does so implicitly.[19] The UN thereby stripped the concept of its potential to fundamentally alter international law.[20] An expansive R2P – what I call R2P* (to distinguish it from the

[14]See Henry Shue, Basic Rights, 2d ed. 52 (Princeton: Princeton Univ. Press, 1980).

[15]Dederer calls these two aspects (along with two additional elements) "cornerstones" of R2P. Hans-Georg Dederer, 'Responsibility to Protect' and 'Functional Sovereignty' in: Peter Hilpold, ed., Responsibility to Protect (R2P): A New Paradigm of International Law? 156–183, 162–163 (Leiden/Boston: Brill/Nijhoff, 2015).

[16]See UN General Assembly Resolution A/60/L.1, para. 138 (15 September 2005); Report of the Secretary-General, Implementing the responsibility to protect, A/63/677, para. 10 (b) (12 January 2009).

[17]One may want to limit the duties to act so as to exclude the legality of taking military action in particular contexts.

[18]Report of the Secretary-General, Implementing the responsibility to protect, A/63/677 (12 January 2009).

[19]UN General Assembly Resolution A/60/L.1, para. 138 (15 September 2005) ("Each individual State has the responsibility to protect its populations from genocide, war crimes, ethnic cleansing and crimes against humanity").

[20]There are many who would argue that R2P must remain narrowly focused to be effective as a motivator for action in those cases in which it was intended. See, e.g., Alex J. Bellamy, The

conventionally accepted version set forth in the 2009 Report) – however, would restore this potential and its impact on climate change discussions would be game-changing.

2.1 R2P*

My concept of R2P*emphasizes the four paradigmatic aspects of responsibility to protect: the obligatory nature of the duties; the call for positive action to be taken in response to risks; the extraterritorial reach of the duties; and its inclusion of any serious threat to human security within its scope. Developed more fully elsewhere, the stronger version of R2P would eliminate the option of ignoring impending catastrophes from the possible legal responses to such threats even when the at-risk population is located abroad and the cause of the damage cannot be attributed to the potential rescuer.[21]

2.2 Climate Change as an Issue for R2P*

As is well-documented, climate change threatens certain populations with severe suffering.[22] From loss of shelter and loss of livelihood to loss of life, the predicted effects will be significant. As a result, the expectation that actions will be needed to effectuate the protection of these populations can therefore be assumed. Moreover, the effects of climate change will be unevenly distributed, with certain populations unharmed by, and some even benefitting from, the changes. Yet, because predictions are that some of the world's weakest economies will be the most negatively affected, we can also assume that for some populations who suffer most, the governments will not be in a position to protect them.[23] Thus, the obligation to take steps to prevent suffering and to assist the victims during and after adverse climate events will fall upon the international community.

Responsibility to Protect: A Wide or Narrow Conception? in: Hilpold, ed., The Responsibility to Protect (R2P), supra n. 15, 38–59, 49–51 (supporting his arguments with citations to Gareth Evans, Ramesh Thakur, Eli Stamnes, and others).

[21] Nadakavukaren Schefer/Arnaiz, supra n. 4.

[22] See generally, IPCC, *Climate Change 2014*: *Impacts*, *Adaptation*, *and Vulnerability*. *Part A*: *Global and Sectoral Aspects*. *Contribution of Working Group II to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change* (Cambridge/New York: Cambridge University Press, 2014) [Field, C.B., V.R. Barros, D.J. Dokken, K.J. Mach, M.D. Mastrandrea, T.E. Bilir, M. Chatterjee, K.L. Ebi, Y.O. Estrada, R.C. Genova, B. Girma, E.S. Kissel, A.N. Levy, S. MacCracken, P.R. Mastrandrea, and L.L. White (eds.)] (www.ipcc.ch/report/ar5/wg2/).

[23] IPCC, 2014: Summary for policymakers. In: *Climate Change 2014*, *supra* n. 22, pp. 1–32, at 6.

R2P* does not rely on taking military action. In fact, most of the obligatory actions that would ever be required for the prevention of (or relief from) human suffering will be in the form of non-military interventions. This is true of climate change hazards, where the actions to be taken will include promulgating regulations, designing policy initiatives, arranging for technology transfers, assisting in the construction of infrastructure, and educating communities in how to adapt to the ecosystem changes that will take (or have taken) place.[24]

Currently, preventative actions are the most relevant ones, and these include both incentivizing low-carbon lifestyles and discouraging high-emission activities. Either type will implicate policies that fall within the scope of investment laws. I turn now to the interaction of investment law and R2P*.

3 Investment Law as a Regime of Positive Duties of States

International investment law determines the protections a government owes to a foreign investor within its jurisdiction. Unlike most areas of international law, it is centered on the relationship between the "host" government and the individual "investor" rather than between two or more states. While the "home" state of the investor was traditionally important as a vessel through which an aggrieved investor could pursue its host, today the home state's role is more diffuse given the wide availability of investors to benefit from investor-state dispute settlement mechanisms found in international investment agreements (IIAs).

One characteristic of investment law is its emphasis on the host state's obligations to actively protect the investor. Governmental restraint is not sufficient to fulfil the obligations IIAs place on hosts, for like human rights, the duties of the host extend from the (mainly passive) recognition of the investor's rights to control her investment to the protection of those rights against threats from third persons and to the affording of restitution should violations to the rights occur. The state, for example, may not expropriate an investor unless it compensates that investor for the value of the taken property. The state must also act so as to ensure the investor enjoys a minimum standard of "fair and equitable" treatment – by issuing information, holding hearings, writing reasoned decisions, and generally maintaining a functioning administration. Most explicitly, full protection and security provisions demand that the host exercise due diligence in protecting the investor and the investment from damage by third persons. This could involve monitoring public sentiment, meditating conflicts, or sending security forces to prevent or halt violent

[24]E.g., IPCC, 2014: Summary, supra n. 22 at 23. Interestingly, even authors who deny the need for governments to focus on climate change as a priority suggest active responses to ensure the effects are minimal in comparison to the offsetting economic growth effects. See Indur M. Goklany, What to Do About Climate Change: Executive Summary, Policy Analysis No. 609, 5 February 2008, 22 (calling for states to strengthen "technologies, human capital, and institutions", implement mitigation measures, and increase scientific knowledge and understanding).

protests from damaging the investor or her property. These standard duties, found in nearly all IIAs, cannot be fulfilled merely by the host refraining from acting – there is a positive action component that is significant.

The same cannot be said about the relationship between the home state and the investor. The only treaty-based obligation facing the home state is a negative duty to refrain from offering the investor diplomatic protection when ISDS mechanisms are initiated.

Being a regime that mainly governs the relationship between a private person, his property, and a foreign government, the structural scope of any inquiries into how investment law relates to climate change is fairly limited. Climate change regulations' impacts on domestic investors, for example, do not fall within the scope of IIAs. Thus, there is no analysis that needs to be done on home states' treatment of their own investors' domestic activities. Neither, however, do the home state's regulations of its investors' foreign activities fall within the realm of investment law. While a government's requirement that any domiciled corporation reduce its global carbon footprint could have effects on the company's foreign investments, that legal relationship is not one subject to IIAs but rather to corporate law (although there may be general international law implications vis-à-vis the host state due to the extraterritorial regulation).

The activities that interest us, then, are those of a government's regulation of foreigners' property as regards climate change. The international investment law protections will apply as fully to such regulations as they would to any other regulations. Yet, the investment law system's attitude to climate change itself is ambivalent.[25]

The protections offered the investor in an IIA do not distinguish among types of investment, the processes employed by the investment, or the impacts of the investment. As long as a foreign "investment" exists, protections apply. (The debates as to whether a project must benefit the host state to be considered an investment have largely died down.[26]) Whether the investment aims to increase the production of solar cells or to mine for brown coal, the compatibility of any regulatory measures applying to these activities with an IIA will depend solely on the impacts of the regulation on the particular investor. The system, in other words,

[25]Miles agrees, writing "investment law does not make moral judgements". Kate Miles, Arbitrating Climate Change: Regulatory Regimes and Investor-State Disputes, 1 Climate L. 63, 66 (2010).

[26]Compare the tribunal decisions upholding a requirement of contribution to host state development in: *Joy Mining Machinery Limited v. Egypt* (ICSID Case No. ARB/03/11, Decision on Jurisdiction of 23 July 2001), para 53; *Jan de Nul N.V. v. Egypt* (ICSID Case No. ARB/04/13, Decision on Jurisdiction of 16 June 2006), para 91; *Helnan International Hotels A/S v. Egypt* (ICSID Case No. ARB/05/19, Decision on Jurisdiction of 17 October 2006), para 77; *Malaysian Historical Salvors Sdn Bhd v. Malaysia* (ICSID Case No. ARB/05/10, Award on Jurisdiction of 17 May 2007), paras 73–74 with those that deny the existence of such a contribution: *Patrick Mitchell v. Democratic Republic of Congo* (ICSID Case No. ARB/99/7, Decision on Annulment of 1 November 2006), para 33; *L.E.S.I. S.p.A. et ASTALDI S.p.A. v. Algeria* (ICSID Case No. ARB/05/3, Decision of 12 July 2006) para 73(iv).

protects economic activity. Investment law is not designed to protect individuals from the effects of climate change.

The system, however, can evolve to better reflect contemporary concerns. Given that climate change is a concern of tremendous global prominence, one could imagine that new IIAs and the interpretation of old IIAs will begin to consider aspects of the impacts of global warming. What would change if R2P* were added to the investment law regime?

4 Adding R2P* to the Investment Law Regime

If the investment law system were to recognize a responsibility of states to prevent human severe suffering, to protect against it, and to rebuild should severe suffering occur despite all earlier efforts, the protections offered to investors would not disappear. Rather, by recognizing R2P* the investment system would add a *normative layer that would shift the existing obligations toward a goal of climate-stabilization*. That is, the system would be subject to a primary value of actively protecting human security – an interest that would determine what a state must do with its investment policy as much as it would determine what it may not do. The key elements of R2P* – mandatory duties of positive action for protection of human security wherever it is seriously threatened – would underlie investment policies just as they would underlie all other governmental policies to ensure the well-being of populations.

The normativity imposed by R2P*'s inclusion of the victim-centered view of security would dictate that investments that aim to increase human security would continue to enjoy all of the protections granted in conventional IIAs – and indeed, perhaps be eligible for even greater protections. Investments that threaten to increase climatic insecurity, on the other hand, not only would be ineligible for protection, but hosts may even be obliged to actively prevent their continued existence.

What does the normative shift mean for individual investment protections? One can hypothesize about the specific changes required by considering the effects of R2P* on various provisions of the typical IIA and on additional duties that would fall upon host governments.

4.1 Definition of Investment

One element of an IIA to discuss is the definition of "investment" and "investor". Whereas today's IIAs define their scope through broad views of what should count as an "investment", focusing largely on conceptions of property, risk, and duration, a climate-sensitive view would be narrower. States subject to R2P* would be required to attempt to limit their promises of protection to those activities that do

not contribute to the risks of climate change. Thus, it would be not only their right, but their duty to define "investment" so as to exclude high carbon emitting assets. At the same time, because states would be obliged to pursue low-carbon economies, they must offer full protection to investments that encourage lower emissions levels or assist in the resilience of local communities. Among other results, it would no longer be permissible to exclude conservation activities from the scope of their treaties. Thus, unincorporated entities such as NGOs specialized in climate change would need to be included in the definition of investor – something that is not available in bilateral investment treaties that limit protection to incorporated entities.

4.2 Expropriation

The right to expropriate would also need to take into account the normative value of human security. The main alteration of practice here would be that the host's right to expropriate would become a duty to do so if an investment is found to be damaging to the climate. The host's currently available policy space for allowing high emissions would therefore disappear. The compensation requirements, however, would not necessarily be affected by R2P*. The duty to stop investors from harming others does not necessarily lead to a prohibition on paying them for their lost profits. If, however, a government can foresee a high number of expropriations, it may have to negotiate about the level of required compensation to ensure that it remains both within the bounds of legality and solvency. Given the equal duties of R2P* on all states, treaty negotiations ought to lead to mutually acceptable levels of required compensation being set forth in IIAs.

An illustration of an expropriatory action where R2P* would make a difference would be one in which a host has a carbon emissions trading scheme in place which is failing to reduce emissions because of a low permit price. The host's duty to protect its population would require it to (inter alia) spur emissions reductions, which it could do by either halting the trading scheme and regulating maximum emissions directly or by taking steps to increase the price of permits through a premature retirement of existing certificates. If it were to choose the less radical second option, any foreign investor would have a plausible claim of expropriation against the host unless compensation was forthcoming. This does not look much different – from the investment law aspect – than it would without R2P* – because R2P* does not demand that states *not* pay compensation. The difference arises if the state is unable to pay the requisite compensation, because in this case, R2P* continues to require the expropriation. The host no longer has the option of not expropriating even though the expropriation is going to be illegal without the offer of compensation. R2P* will in essence require the state to choose the higher norm of human security over the norm of investment protection.

But the effects on investment law will not always be detrimental to the investor's interests. For investments in renewable energy or low-carbon technologies, the

normative working of R2P* will lead to a reinforced protection. Not only would R2P* in such cases maintain any compensation requirement, it may even result in the host's losing its "right" to expropriate given that the government would have a (normatively higher) obligation to promote climate-friendly activities.

4.3 FET

The normative effect of R2P* would also be detectable in the fair and equitable treatment (FET) provisions. While the customary and treaty requirements of fairness to investors would continue to function as a guarantor of good governance, the concept of what is "good" would inevitably be conceived of as including efforts to protect populations from threats of global warming. As a result, a R2P*-based commitment to climate change prevention/mitigation would ensure the host's immunity from charges of legitimate expectations of benefits from climate-damaging investments. Again, however, it would simultaneously offer particularly strong protection to investments that aim to lower emissions or assist the population's resilience to changes.

A major change to current state practice would be the host's positive obligation to enforce its existing environmental laws as a critical aspect of protecting the legitimate expectations of investors in clean technologies and green services. In this respect, R2P* would extend FET protections beyond what is accepted today as the minimum standard of treatment.[27] They may also extend beyond what is generally viewed as the level of treatment expected under autonomous standards – behaviors that are non-arbitrariness, non-discriminatory, intransparent, taken in bad faith, or against the investor's legitimate expectations.[28] Thus, if a host passes legislation that requires transportation companies to offset a portion of their vehicles' GHG emissions with the planting of trees but fails to act against companies who do not, an injured investor (perhaps the owner of a nursery) would have a legitimate grounds for complaint on the basis of a violation of its right to FET.[29]

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[27]The *Neer* standard is widely cited as reflecting the international minimum standard of treatment that a foreign investor can expect. Under Neer, the state should not act in a way that amounts "to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency".L.F.H. Neer and Pauline Neer (USA) v. United Mexican States, 4 R.I.A.A. 60, para. 4 (October 15, 1926).

[28]The tribunal in Gold Reserve v. Venezuela contains a thorough overview of the arbitration jurisprudence on the standard to be applied to autonomous FET provisions. ICSID Case No. ARB (AF)/09/1 paras. 564–576 (22 September 2014).

[29]See Energo-Zelena and Zelena v. Republic of Serbia, ICSID (Energo-Zelena complains of Serbias "systematic omissions to enforce" its legislation to the company's detriment). An interesting further result of R2P* may be that specific performance would have to be included in the remedy.

Another more fundamental addition to the catalogue of FET duties arising from R2P* could be a requirement of legislative consistency. Because the R2P* duty to address climate change is comprehensive, an investor facing restrictions on its own activities may have a legitimate claim of the host's violation of FET if the government has fostered other carbon-intensive activities or even if it has simply failed to regulate such activities without good cause. While over-demandingness is a warranted criticism of R2P in any form, where central aspects of a threat are not regulated by a state, it must be considered as having failed to fulfil its duties of R2P*. The instrument of FET could be a vehicle to address this in the investment context.

4.4 Market Access

Finally, IIA parties would face an obligation to address market access rights of investors with the same normative perspective of R2P*. Under customary law, states have the right to admit or refuse access to foreign investment at will. Some IIAs (particularly those embedded within free trade agreements) now include rights of market access to treaty partner investors, but these are still the exception. The customary discretion in admitting investments, however, would change with R2P*.

If faced with a duty to prevent climate change, states would lose their rights both to offer access to their markets by climate change enhancing entities as well as their right to refuse access by investors intent on lowering GHG levels or mitigating the impacts of change. Again, because the fundamental idea behind R2P* is to require action where there is no political will for it, the discretion currently permitted governments to ignore the security of populations will be curtailed. As in the other elements of investment law, however, this reduction of discretion is based on the normative framework of population-wide human security rather than on investor protection. Thus, it does not exclude investor protection – it in fact supports it – where the investment in question also fosters this security.

5 Conclusion

The international investment law system's relationship to environmental issues is complex but ultimately ambiguous. This is true for questions surrounding the extraction and use of natural resources as well as the regulation of greenhouse gases and the corresponding problems of climate change. Investment law's protection of investors is unconcerned about which investors and which investments are protected, it protects each and all under the assumption that each is equally beneficial to global well-being.

The rise of the idea of sovereignty as responsibility questions this assumption. Its distinctive normative framework imposes an obligation to act for the good of

individuals on states that cannot be ignored on the grounds of political unpalatability or even, according to some versions, illegality.

R2P's limitation of scope hinders its application to many of the world's problems that are causing severe suffering. The logic of sovereign responsibility to act, however, is not inherently so restricted. Covering the concerns of climate change by virtue of global warming's potential to gravely threaten the world's populations, R2P* demands that governments place the protection of their populations before the protection of investors' economic interests. It therefore comes into direct contact with investment law, overlaying it with a normative framework within which investment protections continue to apply only insofar as those protections also protect host populations from the adverse effects of climate change.

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Chapter 21
Comments to "Climate Change, Trade, and Investment Law. What Difference Would a Real Responsibility to Protect Make?"

Shinya Murase

Abstract It is not appropriate to employ the notion of responsibility to protect (R2P) in the context of climate change and in particular in relation to international trade/investment law. Rather than an intrusive notion of R2P, a more moderate concept of "mutually supportiveness" between the climate law and trade/investment law should be pursued.

Keywords Climate change • Responsibility to protect • International trade/investment law • International law commission • International law association

It is quite a unique idea to try to connect the notion of R2P with climate change and trade/investment law that Professor Nadakavukaren Schefer (2016) proposes in her paper. She re-formulates the concept of Responsibility to Protect (R2P) into a new concept of R2P, with an asterisk mark. Under this new concept, R2P is of non-military in nature, but its coverage is expanded to include climate change, beyond those serious crimes such as genocide, war crimes, crimes against humanity and ethnic cleansing, that have normally been considered as R2P's ingredients. With this new concept of R2P to be added, Professor Schefer sees the prospect that trade and investment agreements may be able to cope with climate change.

I must confess that I cannot be as optimistic as Professor Schefer. I certainly share her concern and frustration that nations are not doing anything meaningful to combat global warming. It seems, however, that the concept of R2P, with or without an asterisk, has very little to do with climate change and with trade/investment agreements.

Let me first address the relationship between climate change and R2P. I think that the distance between these two notions is quite remote. As recalled, application

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M. Matsushita, T.J. Schoenbaum (eds.), *Emerging Issues in Sustainable Development*, Economics, Law, and Institutions in Asia Pacific,
DOI 10.1007/978-4-431-56426-3_21

of R2P idea was much debated in connection with the incident of Cyclone Nargis, which brought a catastrophic disaster to Myanmar in May 2008, killing at least 140,000 people, which could be considered attributable to some extent to climate change. In this case, the relief activities of the Myanmar government were obviously inadequate and insufficient. France and the United States sent navy ships carrying relief supplies and demanded to enter into Yangon Port, which was flatly rejected by the Myanmar government. On this occasion, some experts asserted that some forcible actions of humanitarian assistance in the form of R2P was necessary in the face of the imminent situation in Myanmar where its population was largely abandoned by its government.

The International Law Commission completed in 2016 its second reading of the Draft Articles on the "Protection of persons in the event of disasters." The definition of a "disaster" of the Draft Articles, it certainly includes catastrophic environmental damages such as the extreme cases caused by climate change. In the course of the Commission's consideration of the topic, a few members referred to R2P in connection with the States' duty to give assistance to the affected States. However, most members disagreed with the introduction of the intrusive notion of R2P in the context of disaster relief, and the Commission agreed in adopting the Draft Articles on the topic that respect for sovereignty and international cooperation are the bases for the international law on Disasters.[1]

The essential function of the R2P concept is to enable a State or a group of States to intervene by forcible measures in a foreign State without the consent of the latter State or without the authorization of the Security Council under Chapter VII. It is essentially the same as the idea of "humanitarian intervention," which has largely been considered as unlawful under international law. Even if a large-scale disaster occurs as a result of climate change, it would be difficult for a State or States to justifiably employ R2P for undertaking forcible intervention.

Of course, Professor Schefer's new concept of R2P with an asterisk is a more moderate form of interference which would not involve military actions; it is also a broader concept covering climate change.[2] However, the question I see is: where did the concept come from? Was it a part of positive international law, or a proposition *de lege ferenda*, and merely an "aspirational" concept?

This leads to my second reservation, which concerns the relationship between R2P and trade and investment law. It is hardly conceivable that we can establish a linkage between the two. While Professor Schefer is right in accusing States for their

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[1]See ILC Report 2016 at http://legal.un.org/ilc/reports/2014/2016report.htm.

[2]Professor Schefer's concept of R2P* may be closer to what has been contemplated as "Human Security." Japan was a proponent of this idea, which is a moderate and peaceful form of cooperation to assist the people who were suffering from civil wars, natural disasters and poverty in general. "Human Security" was thus proposed as Japan's agenda in the UN and other forums. Then, the idea of R2P has emerged from Canada, overshadowing "Human Security," which has been taken over and subsumed by the more vigorous notion of R2P. I would like to make it clear, however, that R2P is not a notion that is accepted by the international community as a whole, not to mention that it is fully established in positive international law.

unwillingness to do anything effective for preventing the danger of climate change. However, we must admit that the concept of R2P or R2P* will not solve this problem. R2P is not a *uchide-no-koduchi* or "mallet of good luck." It is not a "horn of plenty" or "cornucopia." R2P remains to be merely a political or policy proposal, a *lex ferenda* proposal, rather than being a part of positive law, or *lex lata*.[3]

It may further be questioned whether such a new principle is a part of positive international law. Professor Schefer may consider that R2P* constitutes a "higher law" in the international legal system, a sort of a "peremptory norm" or "*jus cogens*," by which trade/investment agreements derogating from the norm may become invalid. If that is what is contemplated here, I think we are going a bit too far from sensible legal debate.

It is not entirely clear whether Professor Schefer proposes the introduction of the R2P* from the perspective of "treaty interpretation" or from that of "lawmaking." If her concern is with "treaty interpretation," she may be thinking of resorting to a sort of an "evolutionary interpretation" of investment agreements. However, according to Article 31 of the Vienna Convention on the Law of Treaties, methods of treaty interpretation should primarily be based on "ordinary meaning" of the terms of the treaty, "object and purpose" and the "context" of the treaty, before embarking on interpretation by "subsequent agreement" or "subsequent practice." This is another topic before the current International Law Commission. Some of the terms in investment agreements such as "investment," "expropriation," "fair and equitable treatment" and "market access" could come under scrutiny to see if their meanings have undergone any changes over time. However, simply because many of the investment agreements have been concluded rather recently, it may be difficult to apply the "subsequent practice" standard to the interpretation of these agreements.

If Professor Schefer's proposal is to suggest certain lawmaking exercise for new types of investment agreements, that would be fine. However, concluding agreements is in the hands of the State parties, and we must admit that we have little influence over the process. Perhaps, we could envisage making of multilateral agreements on trade and investment, in which R2P* may be placed as a strong guiding principle to govern. However, we all know that the WTO Committee on Trade and Environment (CTE) over the past 20 years has not been able to work out any amendment of GATT Article XX. We all know that the proposed MAI, multilateral agreement of investment, has never become a reality after its failure

[3]Besides, the concept is helplessly ambiguous. What does it mean by "responsibility" in R2P? It does not seem to imply "responsibility of States" for a wrongful act, because it is only the breach of an "obligation" that entails State responsibility. Thus, the word "responsibility" in R2P should mean certain "obligation" of States to protect something. What is it that is supposed to protect by R2P? It should be "human security" rather than "human security." There is a confusion of terminology about "security" and "safety," which should be clearly distinguished. The term "security" implies inter-State relations and involving certain element of forcible measures, while the term "safety" addresses the protection of people by peaceful measures. Thus, the object of protection under R2P should be "human safety" rather than "human security." In any event, it is highly doubtful if R2P can be employed as a guiding legal principle for international trade/investment agreements.

in 1988. It would take ages to reach an agreement of the international community as a whole to incorporate an idea of something similar to R2P in multilateral treaties on trade and investment.

While admittedly there is need for reform in trade and investment agreements as suggested by Professor Schefer, the degree of impacts that these agreements have on climate change should be quite limited. What is necessary is to regulate States directly to comply with international norms and standards to reduce greenhouse gas emissions. What we can do utmost about trade and investment agreements is to ensure "mutually supportive" coordination with the law of climate change. This is a modest form of "horizontal" coordination rather than the "vertical" adjustment of investment law under R2P-oriented climate law.

It was from such a perspective that the International Law Association (ILA) adopted a set of Draft Articles on the "legal principles relating to climate change" at its Washington Conference in April 2014. Its Article 10 regarding "Inter-Relationship" provided for "Climate change and International trade and investment" in paragraph 3 (a) that "States shall ensure that legal progress regarding climate, trade and investment in ongoing negotiations conforms to the principle of 'mutual supportiveness'."[4] It is a very modest statement, but this is probably what we can hope for, given the current stage of development of international law.

The International Law Commission (ILC) commenced its work on the "Protection of the atmosphere" in 2014, for which I serve as Special Rapporteur. The Commission tries to cover all the atmospheric problems by its draft guidelines in a comprehensive manner.[5] It is planned that it will address the question of interrelationship between the law of the atmosphere and the law of trade and investment in our future draft guidelines (possibly in 2017), but here again, it has to be a modest reminder of mutual supportiveness, and not much more.

After all, it is the political processes that make substantive difference in climate change and trade/investment issues. The role of lawyers in this process is quite limited and modest.

Reference

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[4] http://www.ila-hq.org/en/committees/index.cfm/cid/1029 See the first to third reports (2010–2014) of the ILA Committee on the Legal Principles relating to Climate Change, for which the present writer served as Chair.

[5] See the First Report (A/CN.4/667, 2014), Second Report (A/CN.4/681, 2015) and Third Report (A/CN.4/692, 2016). See for the draft guidelines and commentaries thereto so far adopted, ILC Report, 2015, Chapter V. http://legal.un.org/ilc/reports/2016/.